U.S. Department of the Interior
Minerals Management Service

Annual Financial Report
Fiscal Year 2005

MMS

Securing Ocean Energy &
Economic Value for America

Ocean Princess Semisub at sunset

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Message from the Director

It is my pleasure to provide the Fiscal Year 2005 Annual Financial Report of the Minerals Management Service (MMS).

The financial and performance data it presents are complete and reliable as outlined in Office of Management and Budget guidance. This report also presents the status of the Bureau's compliance with certain legal and regulatory requirements. The annual assurance statement required by the Federal Managers' Financial Integrity Act (FMFIA) concludes that MMS can provide reasonable assurance that its systems of management, accounting, and administrative controls, taken as a whole, meet the objectives specified in Section 2 of the FMFIA. These objectives are intended to ensure that: (1) programs achieve their intended results; (2) resources are used consistent with agency mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and (5) reliable and timely information is obtained, maintained, reported and used for decision making. The MMS prepares annual Financial Statements to help fulfill its responsibility to be publicly accountable, and to manage its programs efficiently and effectively. To provide greater assurance on the integrity of financial operations and the accuracy of financial data, MMS undergoes annual Financial Statement audits. The MMS obtained an unqualified opinion on its Financial Statements in FY 2005 and FY 2004. While MMS has made significant progress in enhancing its overall control environment we have not been able to eliminate all instances of reportable conditions or non-compliance with applicable laws and regulations. Additional information regarding MMS's financial statements is located within the Discussion and Analysis of the Financial Statements section of this document

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 plays a key role in America's energy supply by managing the mineral resources on 1.76 billion acres of the OCS. The approximately 47 million leased OCS acres account for 21 percent of America's domestic natural gas production and 30 percent of America's domestic oil production. Within the next 5 years, given the expected significant growth in deepwater production, OCS production could account for more than 40 percent of U.S. oil production and 23 percent of U.S. natural gas production. MMS's oversight and regulatory frameworks ensure that this production and drilling are done in an environmentally responsible manner and done safely. MMS also ensures that the country receives fair value for its mineral resources, and collects, accounts for, substantiates, and disburses more than $8 billion annually. Revenue collected from Federal and Indian gas and oil production is distributed to recipients such as the U.S. Treasury, states, special purpose trust funds such as the Land and Water Conservation Fund, and the Office of the Special Trustee for American Indians for disbursement to tribes and individual Indian mineral owners.

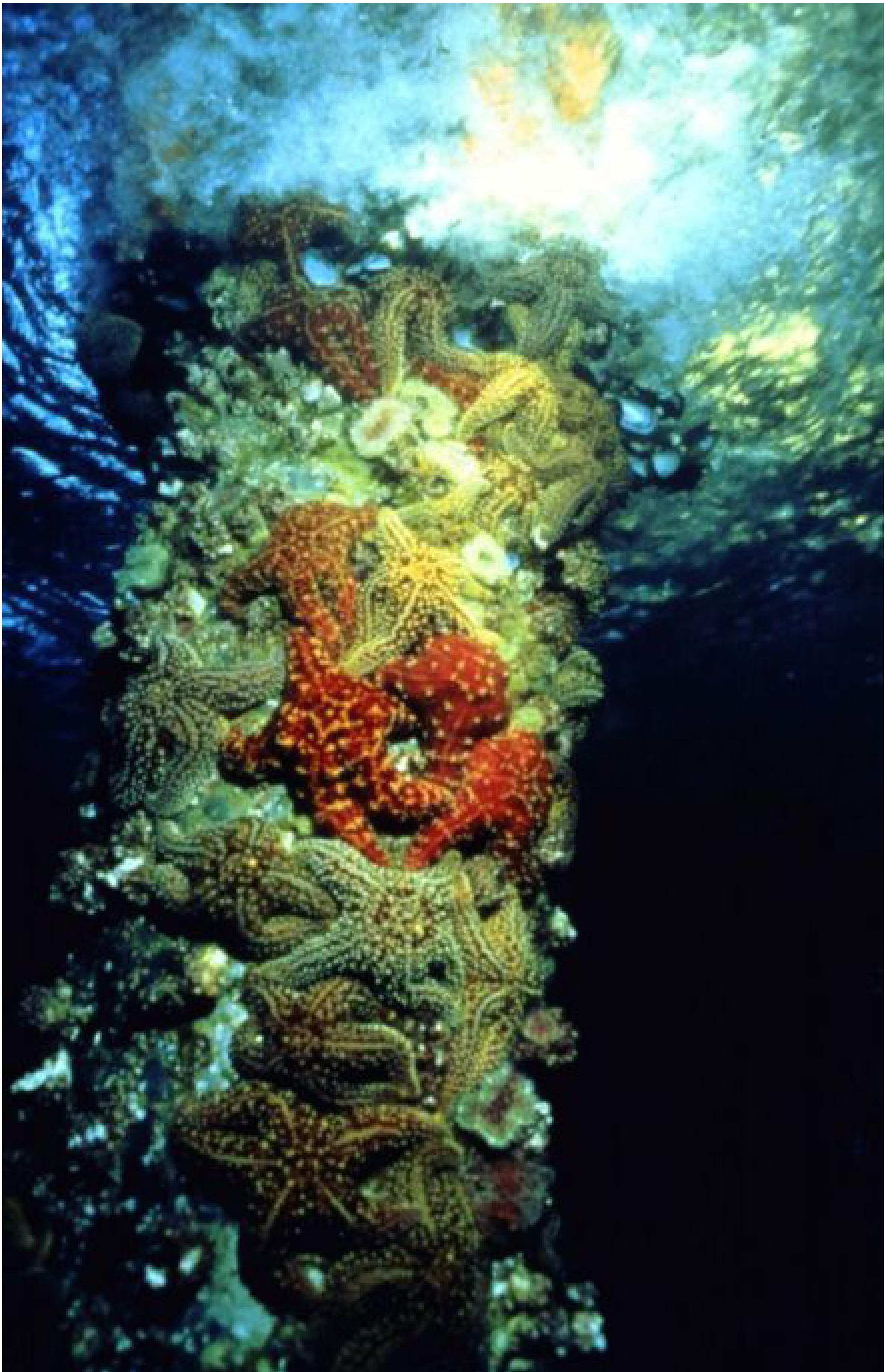
America currently relies on foreign sources for more than half of our oil supply. Over the next two decades, our demand for crude oil is expected to grow by 35 percent and our demand for natural gas is expected to grow by 37 percent. The Strategic Petroleum Reserve (SPR) provides a critical buffer for potential disruptions in oil supplies, and during 2005, MMS completed delivery of in-kind oil to fill the SPR to 700 million barrels in response to a 2001 Presidential directive. 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. Under the recently passed Energy Policy Act, MMS provides the statutory authority to expand this initiative.

On August 8, President George W. Bush signed the Energy Policy Act of 2005. MMS will implement our new responsibilities and continue helping America meet its energy needs. The Act expands the authority of the Secretary of the Interior conveying to MMS new authorities and responsibilities for offshore alternative energy activities, including wind, current, wave, solar and other support activities for the traditional offshore oil and gas. Under this statutory provision MMS will work with industry, states, and other interested parties to increase renewable energy production on Federal offshore lands. The Act also contains two provisions impacting the revenue operations of MMS. The Act provides royalty-in-kind (RIK) authority to allow the Secretary of the Interior to use revenue from the sale of oil and gas taken in-kind to pay for costs associated with the RIK program. It also provides new authority allowing the Secretary of the Interior to offer royalty relief to existing OCS leases off Alaska. As the lead Federal agency for offshore renewable energy projects, we will strive to protect the environment, protect the lives and property of industry workers and our communities, and bring new sources of energy to our Nation while ensuring fair value for America's renewable resources.

In late August 2005, Hurricane Katrina moved through the Gulf of Mexico. As the Hurricane approached, MMS implemented its Gulf of Mexico Continuity of Operations Plan (COOP) and moved key personnel to Houston. Following the storm, human life took precedence as helicopters, boats and efforts were diverted to provide humanitarian aid to those persons devastated by Hurricane Katrina. Nevertheless, within hours after Katrina moved through, the COOP team and other MMS employees began the complex process of facilitating restoration of energy production in the Gulf. At the peak of Hurricane Katrina on August 30, approximately 95 percent of daily oil production and 88 percent of daily gas production were shut-in. During late September, Hurricane Rita moved through a highly productive part of the Gulf of Mexico (GOM). One-hundred percent of Gulf oil production and nearly 80 percent of gas production was shut-in. MMS had to re-evacuate its COOP office to Virginia to deal with the emergency. From the initial shut-in on August 26, 2005 through September 30, 2005, the cumulative shut-in oil production was about 8% of the yearly production of oil and 6% of the yearly production of gas in the GOM. These two storms have done substantial damage to the offshore infrastructure with the damage to pipelines still being assessed. However, industry is restoring operations including implementing innovative means for handling the massive disruption of this one-two punch. MMS is coordinating closely to ensure we streamline the red tape while maintaining the oversight required for safe and environmentally responsible operations.

MMS is 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 bureau 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
October 6, 2005



California Starfish on platform leg

MISSION AND ORGANIZATION

The Minerals Management Service (MMS), a Federal Bureau within the U.S. Department of the Interior (DOI), manages the Nation's natural gas, oil, and other mineral resources on the Outer Continental Shelf (OCS). The Bureau also collects, accounts for, and disburses more than $8 billion per year in revenues from Federal offshore mineral leases and from onshore mineral leases on Federal and Indian lands. MMS's activities provide major economic and energy benefits to taxpayers, states, and the American Indian community.

> MMS Mission Statement:
> *Manage the mineral resources on the Outer Continental Shelf and Federal and Indian mineral revenues to enhance public and trust benefit, promote responsible use, and realize fair value.*

The MMS has approximately 1,700 employees across the United States. The MMS Headquarters is located in Washington, D.C., with offices in Herndon, Virginia; New Orleans, Louisiana; Camarillo, California; Anchorage, Alaska; Lakewood, Colorado; Houston and Dallas, Texas; Tulsa and Oklahoma City, Oklahoma; and Farmington, New Mexico. The Agency has two primary operating programs: *Offshore Minerals Management* (OMM) and *Minerals Revenue Management* (MRM), supported by the Directorates of Policy and Management Improvement and Administration and Budget, as well as the Offices of Public and Congressional Affairs.

Every American benefits as a result of MMS's efforts, from the gasoline that powers our cars and the natural gas that heats our homes to the benefits obtained through the disbursement of collected mineral revenues.

Mandated Duties Serving the American Public

MMS has the responsibility of managing mineral resources on the Outer Continental Shelf, and for the fiscal accountability and management of the public's mineral resources. The Outer Continental Shelf Lands Act of 1953 called for the Federal Government to manage the oil, gas, and other mineral resources of the OCS to ensure national security, reduce dependence on foreign sources, protect the Nation's environmental health, and conserve the precious resources of the OCS. The MMS was created by Secretarial Order 3071 in January 1982, based on a recommendation by the Independent Commission on Fiscal Accountability, that stated proper fiscal accountability and management of the public's mineral resources would best be served by a bureau devoted to minerals management. The Federal Oil and Gas Royalty Management Act of 1982 (as amended) mandates the manner in which MMS manages revenues from leasable minerals.

MMS Asset Management Process

> *"The MMS is helping secure America's energy future and quality of life, while protecting the environment and providing fair equity for the use of Federal lands."*
>
> R. M. "Johnnie" Burton
> MMS Director

The MMS is one of America's leading mineral asset managers. The Agency manages assets that generate 30 percent of America's domestic oil production and 21 percent of domestic natural gas, and provides over $8 billion in annual revenues to States, American Indians, and the Treasury. Through the MMS asset management process, MMS ensures optimal value for America's mineral resources in the Gulf of Mexico and on Federal and Indian Lands. The organization's mandated mission is carried out through the Offshore Minerals Management and the Minerals Revenue Management programs.

The *Offshore Minerals Management* program (OMM) manages pre-lease and post-lease activities that range from the initial geological and geophysical analysis of OCS resource potential and the leasing process to monitoring the safety of offshore facilities and protecting our coastal and marine environments. In addition to oil and gas resources, MMS provides access to State and local governments for the recovery of sand and gravel used to protect the Nation's coastal shores and wetlands. New responsibilities include offshore renewable energy and coastal impact assistance grants.

The *Minerals Revenue Management* program (MRM) collects, accounts for, and disburses revenues from mineral production on leased Federal and Indian lands. The revenues are collected by taking royalty-in-value (cash) or royalty-in-kind (product). Revenue is only collected in-kind if there is an economic advantage to the Government. Where the use of RIK provides increased revenues, greater administrative efficiency, or meets a security need of the Nation, MMS will collect royalties in-kind, sell the product in the marketplace, and disburse resulting revenues as prescribed by law. Through its compliance activities, MMS ensures the American people receive fair value for their domestic resources. Revenues collected by MMS are one of the largest sources of non-tax revenue to the Federal Government.

MMS is committed to serving our country in the best, most efficient manner possible throughout all of our business activities.

"Reliable and affordable energy is critical to our economic security."

President George W. Bush

Continental Peregrine Falcon

MMS: SECURING OCEAN ENERGY AND ECONOMIC VALUE FOR AMERICA

MMS Asset Management Process

mineral asset analysis

Offshore mineral resources management

- perform environmental & engineering analysis
- assess resources and assure fair value
- issue and manage leases

Federal and Indian mineral revenues management

- analyze marketing, transportation & economics
- select in-value/in-kind
- account for revenues

pre-leasing

post-leasing, pre-production

production & post-production

revenue collection

fund disbursement

compliance assurance

develop and enforce regulations
consult with stakeholders
forge partnerships

Benefits for the American People

Energy

Energy for consumers
Strategic Petroleum Reserve
Environmental protection
Worker safety

Revenue

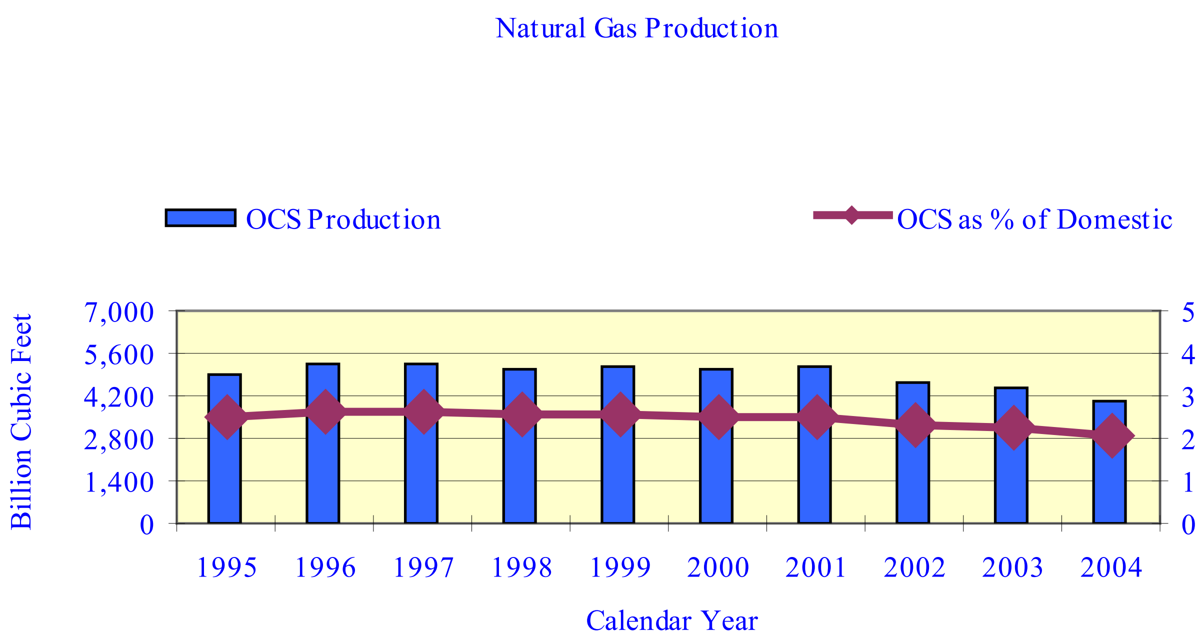
Dollars to states and American Indians
Dollars to Treasury and environmental and cultural funds
American Indian Trust protection

Helping Meet the Energy Needs of the Nation

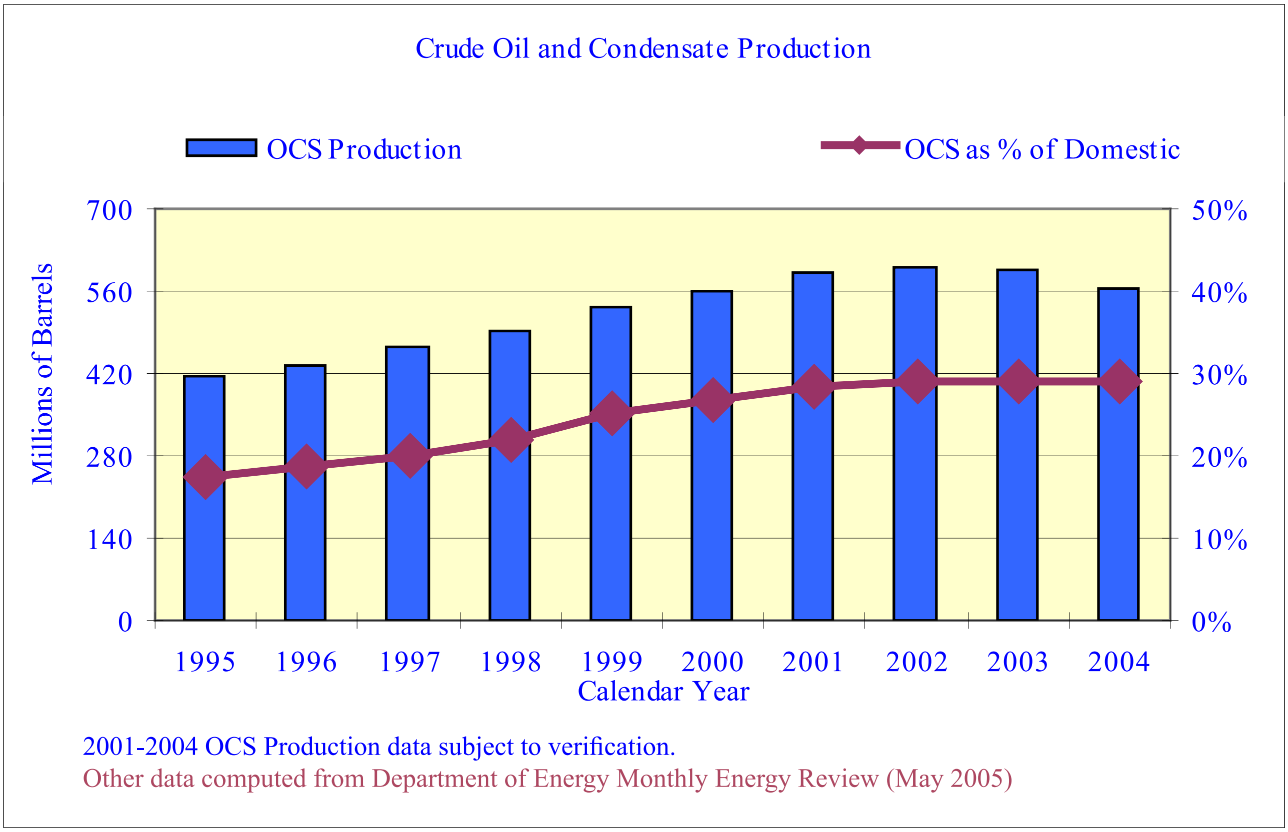
One of the cornerstones of President Bush's National Energy Policy is the role MMS plays in securing ocean energy for the Nation. To date, the Outer Continental Shelf (OCS) has contributed approximately 15 billion barrels of oil and 165 trillion cubic feet of natural gas for U.S. consumption. The MMS now administers over 8,500 leases, and nearly 4,000 offshore facilities. This is a 125 percent increase in leases since 1982. It is anticipated that this trend will continue with the growing interest in deepwater production in the Gulf of Mexico.

The offshore areas that MMS has designated for leasing consideration under the current 5-year Oil and Gas Leasing Program could yield as much as 22 billion barrels of oil and 61 trillion cubic feet of natural gas. Within the next 5 years (2010), given the expected significant growth in deepwater production, OCS production could account for more than 40 percent of U.S. oil production and 23 percent of U.S. natural gas production. It also may hold a potential future supply of natural gas from methane hydrates that could supply America's needs for natural gas for hundreds of years. MMS plays a vital role in providing safe and environmentally sound access to these domestic energy resources.

In 2004 MMS initiated the multi-year process of developing a new 5-Year Oil and Gas Leasing Program (2007 – 2012), as required by the OCS Lands Act. On August 24, 2005, MMS published a Federal Register notice seeking initial public comment on the development of the new 5-year plan and accompanying environmental impact statement.



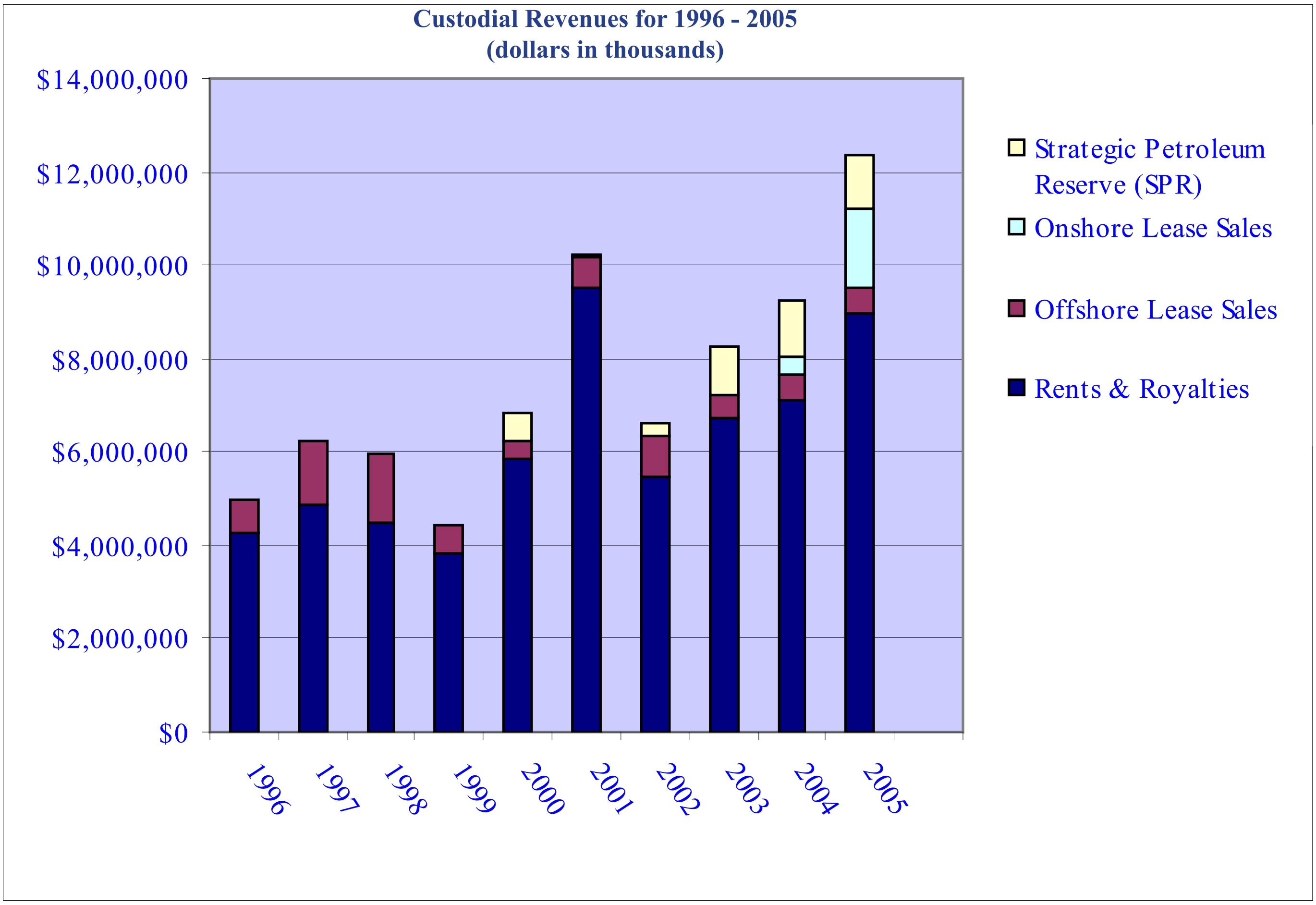
2001-2004 OCS Production data subject to verification.
Other data computed from Department of Energy Monthly Energy Review (May 2005)



Providing Economic Value

Every American benefits from mineral resource development on Federal lands, whether derived by energy produced from the lands or revenues generated from those natural resources. Mineral revenues over the last 10 years are shown in the following chart. In FY 2005, MMS collected more than $10 billion in mineral revenues. In addition, MMS delivered approximately 25.6 million barrels of in-kind oil, valued at an estimated $1.2 billion, to the Department of Energy (DOE) for the Strategic Petroleum Reserve (SPR).

In the mid-1990s, MMS began exploring the potential to take royalty volumes (in-kind) rather than royalty cash payments and then competitively selling these royalty volumes monetizing the royalty value. While the Secretary of the Interior has utilized this Royalty in-Kind (RIK) authority for the small refiner program since 1970, several pilots were launched in the mid 1990's. Based on these pilots and two years as a formal program, the RIK program has demonstrated that it returns a fair value on the public's royalty assets, reduces regulatory costs and reporting requirements, shortens the compliance cycle, and improves overall business efficiencies. In addition, taking royalties "in-kind" simplifies audits and reduces conflict associated with valuation of mineral royalties.



Note: SPR revenues represent the value of oil taken in-kind for delivery to the SPR rather than dollars.
Beginning in FY 2005 the Statement of Custodial Activity was revised to present an additional revenue category for onshore lease sale activity. For comparative purposes in the current Statement, FY 2004 was also revised to include this category. This chart reflects those revisions.

Interior Franchise Fund (IFF)

Established pursuant to the Government Management Reform Act (GMRA) of 1994, the IFF pilot program's objective is to reduce the cost of government by providing common administrative products and services to other Federal agencies on a competitive, fee-for-service basis. The IFF's primary line of business, acquisition operations, is conducted by GovWorks, a division within MMS's Associate Directorate for Administration and Budget.

GovWorks is a preferred provider of Acquisition and Federal Assistance services for Federal agencies. Full-service acquisition and Federal assistance support include: project planning (acquisition strategy); soliciting and evaluating offers; awarding and administering contracts; and monitoring agreements through closeout. Clients receive assistance with project management activities from the preparation of the statement of work through contract sourcing and expenditure tracking. Since its inception in 1996, GovWorks, under the guidance of MMS management, has grown to approximately 180 employees, with approximately $1.5 billion in annual revenue.

As discussed below under the discussion of the financial statements, Department of the Interior Management announced its intent to realign the IFF with the Departments National Business Center (NBC), effective October 2nd, 2005. Upon final approval by OMB and the completion of the realignment, the IFF will no longer be reported as part of the MMS reporting entity. Additionally, GovWorks will transfer to the NBC.

PERFORMANCE GOALS AND RESULTS

The Government Performance and Results Act (GPRA) requires Federal agencies to formulate Strategic Plans, identify major strategic goals, and report performance related to those goals. In FY 2003, the Department of the Interior published an integrated Strategic Plan (2003-2008), which replaced the previous separate Bureau plans. The MMS 2005 Operational Plan describes what the Bureau planned to accomplish during the year to achieve the long-term performance goals in the DOI Strategic Plan. MMS reports on actual performance results below and in the Department Performance and Accountability Report published in November.

In FY 2005, MMS conducted a follow-up data verification review of GPRA measures. The Bureau's internal review found that internal processes and documentation exist for all measures, and that GPRA measures and the results are relevant and reliable.

Also in FY 2005, MMS began an upgrade of its Activity Based Costing/Management (ABC/M) system to incorporate a broader view of costs related to performance. It is anticipated that a revision of the ABC/M model by FY 2006 will enhance the business ability to link performance to costs and strategy.

The following is a discussion of MMS's key goals, measures, and performance as they pertain to these goals.

OCS Leasing Activities

DOI End Outcome Goal	Measure	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Planned	FY 2005 Actual
Resource Use: Manage or influence resource use to enhance public benefit, promote responsible use and ensure optimal value - *energy*	Number of lease sales held consistent with the Secretary's Five Year Program	3	3	4	4	4

To facilitate mineral production on the OCS, the Department of the Interior prepares a five-year schedule of proposed oil and gas lease sales. The schedule includes lease sales in the available areas of the OCS (i.e., those areas not under congressional moratorium or executive withdrawal), that have the highest resource value and expected interest to industry, while recognizing environmental values, economic conditions, and competing uses. There are 20 lease sales planned for the current 5-year program (2002–2007), including three "special sales" in frontier areas offshore Alaska.

Over time Congress has modified the statutory authorities for royalty relief, and MMS has developed a suite of economic incentives designed to stimulate industry interest in bidding for OCS leases where the geologic risk is high and/or the finding cost is large. OCS production will help to ensure the Nation's economic security by providing a reliable domestic supply of energy resources. With Deepwater and Shallow Water/ Deep-Gas royalty relief incentives in place for certain zones of the Gulf of Mexico, lease sales in the central and western planning areas have continued to receive active bidding and expand exploration. Another notable highlight of FY 2005 lease sales was the strong interest in the Beaufort Sea, offshore Alaska. The Beaufort Sea is estimated to have approximately 9 billion barrels of technically recoverable oil.

During FY 2005, MMS conducted the following sales:

Central Gulf of Mexico Sale 194 was held as scheduled March 16, 2005. The sale attracted 651 bids on 428 tracts, with high bids totaling $353,961,798. MMS rejected 19 high bids totaling $11,931,635 as insufficient for fair market value. A total of 403 tracts were leased for an amount of $342,027,467.

Eastern Gulf of Mexico Sale 197 was held as scheduled March 16, 2005. A total of 10 leases were issued with bonus bids totaling $6,501,059.

Beaufort Sea Sale 195 was held as scheduled March 30, 2005. A total of 117 leases were issued bringing bonus bids totaling $46,573,779. Issuance of these leases nearly tripled the Alaska Region's active lease inventory.

Western Gulf of Mexico Sale 196 was held as scheduled August 17, 2005. The sale attracted 422 bids from 56 companies on 346 tracts, totaling $285,192,865. Bid analysis is ongoing to determine whether the bids are sufficient to ensure receipt of fair market value. As of September 30, 2005, 90 bids have been accepted by MMS, and the bidders subsequently notified.

Ensuring Safe and Clean Operations

DOI End Outcome Goal	Measure	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2005 Actual
Serving Communities: Protect lives, resources and property	Number of fatalities among workers in DOI permitted activities	7	11	3	Reduce from adjusted 5-year average of 5	3 Partial Data*
Serving Communities: Protect lives, resources and property	Number of serious injuries among workers in DOI permitted activities	21	23	29	Reduce from adjusted 5-year average of 24	16 Partial Data*
Resource Use: Manage or influence resource use to enhance public benefit, promote responsible use and ensure optimal value - *energy*	Achieve an oil spill rate for offshore development of no more than .00001 barrel spilled per barrel produced	0.0000002 Corrected	0.0000041	0.0000082 Includes worst-case estimates for spills related to Hurricane Ivan (September 2004)	0.00001	0.0000085 Preliminary Estimate**

* Partial Data, covering the first three quarters of FY 2005 (October 2004 – June 2005). Complete data are unavailable due to disruption of MMS operations and data access issues related to Hurricane Katrina.
** Preliminary Estimate. Final results are pending completion of ongoing industry assessments and MMS investigations and verification procedures. Actual results may vary significantly.

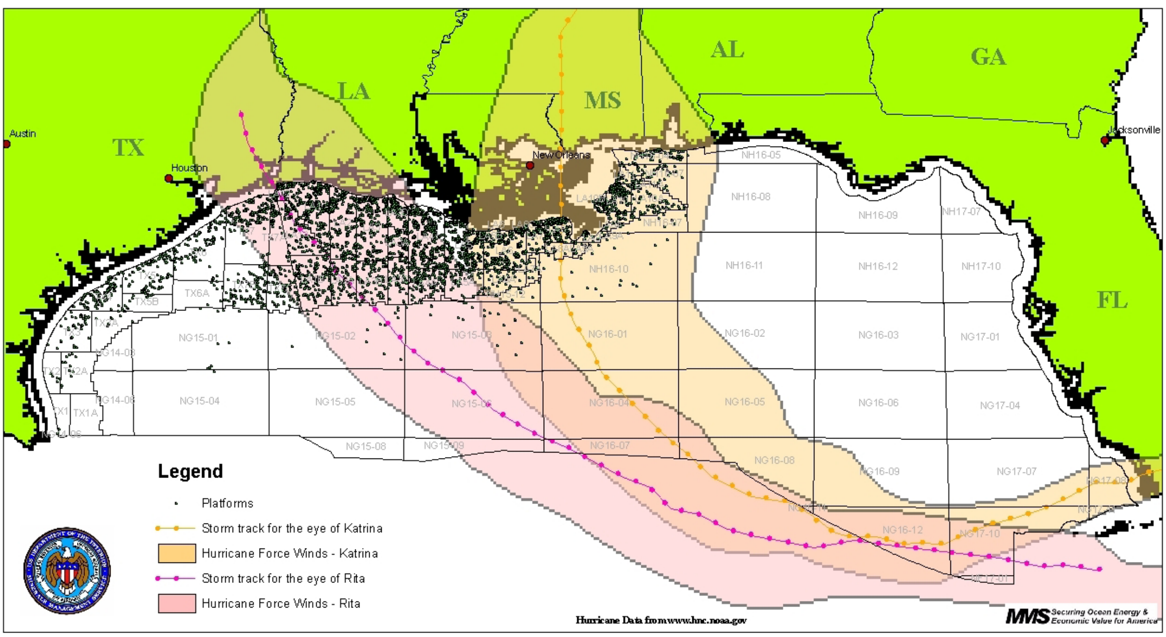
Over the last 50 years, the safety and environmental record of the offshore industry has dramatically improved. The Nation has much to gain from excellent offshore safety and environmental performance because the production and consumption of energy are fundamental components of economic development, national security, and societal well-being. The MMS's ongoing commitment to safe and clean operations is a prerequisite for all activity on the OCS.

The MMS conducts thousands of inspections each year to ensure the safety of the oil and gas workforce and the protection of marine, coastal, and human environments. Prevention is our most important safety strategy. Annual inspections examine safety equipment designed to prevent blowouts, fires, spills, and other major accidents. MMS inspectors have authority to shut down an operation immediately if it is being conducted improperly or without proper equipment.

MMS closely monitors and analyzes incident-related data to understand the cause and occurrence of offshore accidents and spills and to identify actions that can be taken to prevent occurrence of similar incidents in the future. Complete data are unavailable due to disruption of MMS operations and data access issues related to Hurricanes Katrina and Rita (August and September 2005). Data for the first three quarters of FY 2005 show 3 fatalities and 16 serious injuries reported by OCS operators. By comparison, the annual average over the previous 5-year period was 6 fatalities and 25 serious injuries. Though the true target for these outcomes is always zero, MMS had established an expected value performance goal of reducing fatalities and serious injuries to a level not to exceed 5 and 24, respectively, for the year.

MMS is addressing several areas of safety concern by considering regulatory options for requiring operators to incorporate new procedures in their safety and environmental management practices to meet our shared goal of enhancing the safety of OCS operations. As further analysis proceeds, the Offshore Program will pursue a strategic initiative to reduce the number and severity of OCS accidents, assuring worker safety while protecting the marine environment.

Hurricanes Rita and Katrina, August - September 2005



In late August 2005, Hurricane Katrina moved through the heart of the Gulf of Mexico's oil and gas production fields, followed by Hurricane Rita the next month. Reports received during the first few weeks following these storms indicate that, of the approximately 4,000 structures in the Gulf, more than 100 have been destroyed (some are single-well caissons). For the major facilities built to the 1988 design standards, only one of these facilities was destroyed. Additionally, a number of drilling rigs were damaged and five were destroyed. The extent of pipeline damage remains to be assessed, but because there were no indications of major mudslides, less damage to the offshore pipeline infrastructure is expected than was the case with Hurricane Ivan (September 2004). However, onshore impacts from Katrina and Rita disrupted the lives of much of the industry's workforce and wrought extensive damage to facilities needed to bring OCS resources to market. Finally, the good news is that the shut-in technology worked and as of October 6, there were no significant spills reported from any offshore well on the OCS.

The MMS is studying the forces at work during Hurricanes Ivan, Katrina, and Rita and the consequential damages offshore in order to determine the effectiveness of existing design standards. The MMS will assess improved technology and science to develop recommendations on design and operation.

DOI End Outcome Goal	Measure	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2005 Actual
Resource Use: Manage or influence resource use to enhance public benefit, promote responsible use and ensure optimal value - *energy*	Percent of revenues disbursed on a timely basis per statute	80%	92.6%	95.5%	96%	98%
Serving Communities: Fulfill Indian fiduciary trust responsibilities: Improve Indian Trust ownership and other information	Transfer X% of revenue to OST within 24 hours of receipt	N/A New Measure	99.3%	100%	99%	100%
Serving Communities: Fulfill Indian fiduciary trust responsibilities: Improve Indian Trust ownership and other information	Provide lease distribution data to BIA for X% of royalties by first semi-monthly distribution	N/A New Measure	N/A New Measure	84%	75%	92%

The MMS collects and processes reports and payments from bonuses, rents and royalties from approximately 3,700 reporters representing 26,000 producing leases each month. The MMS distributes and disburses these revenues directly to States, the Office of Special Trustee for American Indians (OST), other Federal agencies and U.S. Treasury accounts. The distribution and disbursement function ensures that revenues are properly disbursed to the appropriate recipients. The MMS achieved 98 percent timely disbursements, meeting its FY 2005 goal of 96 percent.

The MMS contributes to DOI's ability to provide accurate and timely information and revenues to Trust beneficiaries. As an example, MMS transfers American Indian mineral revenues to OST on a daily basis. OST in turn, deposits funds into interest-bearing accounts. MMS has established a measure to document the percentage of all Indian revenue received on a daily basis transferred to OST within 24 hours of identification, and in FY 2005, MMS achieved 100 percent timely transfer.

The Bureau of Indian Affairs (BIA) requires Financial Distribution Report (FDR) information in order to distribute funds to individual Indian mineral owners. MMS provides this lease distribution data to BIA twice each month. MMS is improving the timeliness of sending lease distribution data to BIA, thus enhancing BIA's ability to provide revenues more quickly to the ultimate Trust beneficiaries. The MMS exceeded its FY 2005 goal of 75 percent, providing 92 percent of American Indian lease distribution data to BIA by the first semi-monthly distribution.

Mineral Revenue Compliance Activities

DOI End Outcome Goal	Measure	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2005 Actual
Resource Use: Manage or influence resource use to enhance public benefit, promote responsible use and ensure optimal value - energy	Royalties received for mineral leases are X% of predicted revenues, based on market indicators in the production year.	N/A New Measure	N/A New Measure	96.1% of predicted revenues (75% of 2001 royalty universe	98% of predicted revenues for 2002 royalty universe	98% predicted revenues (75% of 2002 royalty universe)
Resource Use: Manage or influence resource use to enhance public benefit, promote responsible use and ensure optimal value - *energy*	Compliance work is completed within the 3-year compliance cycle for X% of royalties for production year X.	10.5% of 1999 royalties	46% of 2000 royalties	69.4% of 2001 royalties	69% of 2002 royalties	71% of 2002 royalties

Mineral revenue compliance activities represent a large and critical part of MMS's operational strategy to ensure timely and correct payment for minerals produced on Federal and Indian leased lands. The MMS predicts expected revenues, analyzes variances, performs targeted and random audits, resolves valuation discrepancies, and negotiates settlements to ensure that optimal value is received by the American taxpayer and Indian recipients.

One compliance measure is a ratio comparing actual payments to predicted revenues. This measure provides an indication of not only how well industry is complying with MMS regulations and reporting guidelines, but also how effective are MMS's regulations and oversight at driving compliance. Utilizing the results from this measure, MMS coordinates with select companies to resolve issues and improve timeliness and accuracy of future reporting. In FY 2005, MMS measured CY 2002 royalty payments and determined that company payments were 98 percent of predicted revenues (for properties representing about 75 percent of all CY 2002 royalties).

The MMS performs analysis on variances between actual and predicted payments through the end-to-end 3-year compliance process. During the MRM reengineering effort, MMS established a goal to reduce the 6-year compliance cycle by half. The MMS has demonstrated the feasibility of completing the compliance function in 3 years or less. The MMS is continuing to expand compliance coverage within the shortened compliance cycle to ensure that the Government is realizing fair market value, and that companies are in compliance with applicable laws, regulations and lease terms. In FY 2005, MMS completed compliance work within 3 years for 71 percent of the entire 2002 royalty universe.

During FY 2005, MMS also completed implementation of all 39 actions in MMS's Audit Quality Improvement Action Plan, a comprehensive plan to improve MRM's compliance and audit activities and related internal controls. In late FY 2005, MMS initiated an external peer review of MRM audit activities, and expects the external auditor results by December 31, 2005.

Interior Franchise Fund

Measure*	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Plan	FY 2005 Actual
Maintain a cost of contract dollars awarded that is less than the governmentwide benchmark of 2 cents per dollar awarded	$0.02	$0.01	$0.02	$0.02	$0.02

*This measure is not a GPRA measure

The Interior Franchise Fund (IFF) monitors the costs per contract dollar awarded as a key indicator of the organizations efficiency and performance measured against a common governmentwide benchmark. In FY 2003, the IFF substantially increased contract dollars awarded without a corresponding increase in operating costs. This resulted in a decrease in cost per contract dollar awarded. While the FY 2003 level of effort could be maintained without increasing costs in the short term, to sustain the effort over the long term the IFF was required to increase its labor force to maintain quality. The increase in labor costs and the associated overhead the IFF cost per contract dollar awarded increased to the goal of $0.02 per contract dollar awarded in FY 2004 and FY 2005.

SIGNIFICANT ACCOMPLISHMENTS

MMS Marks 50th Anniversary of the First Offshore Lease Sale

The MMS recently commemorated the 50th Anniversary of the first Federal offshore oil and gas lease sale held on October 13, 1954.

At the first lease sale, the Federal Government leased 90 of the available 199 tracts, with a total bonus paid to the U.S. Treasury of $116.3 million. Twenty-six of those 90 tracts leased 50 years ago remain active today and continue producing oil and gas; thus far they produced 507,774,911 barrels of oil and 1,943,179,702 cubic feet of natural gas.

Deepwater: America's Expanding Frontier

> *"The deepwater area of the Gulf of Mexico continues to rapidly unfold as the major domestic energy source for the United States."*
>
> Chris Oynes
> MMS Gulf of Mexico Regional Director

To meet the Nation's energy needs, America's oil and gas industry now produces energy resources in water depths greater than 7,000 feet and is exploring in record depths.

Under the President's National Energy Policy, the Interior Department has been providing incentives to energy companies to reduce the financial risk of exploring in technologically challenging, high-risk areas, such as deep-water and deep-shelf areas of the Gulf of Mexico. Additional incentives are to be provided as the MMS implements provisions of the Energy Policy Act of 2005. These incentives, which take the form of royalty relief, ensure taxpayers a fair return, while making it worth the risk for companies to explore hard-to-reach reserves. The Department expects the incentives to boost domestic production of oil and natural gas significantly over the next decade.

MMS Proposes New Incentive for Ultra Deep Drilling

The MMS issued a proposed rule in February 2005 that will allow Suspensions of Operations (SOO) to oil and gas lessees or operators who plan to drill ultra deep wells. The proposed rule, which MMS anticipates finalizing in November 2005, would encourage drilling of ultra deep wells to depths of at least 25,000 feet true vertical depth sub-surface by granting a SOO in certain situations. The MMS expects the new rule will lead to increased drilling of ultra deep wells and increased domestic production.

Generally, when a lease reaches the end of its primary term, the lessee must be producing or conducting other lease-holding operations to extend the lease beyond its primary term. However, due to the added complexity and costs associated with planning and drilling an ultra deep well, MMS recognizes that more time may be needed for exploration and development. In such cases, the lease term could be extended through a SOO.

Although some leases with 10 year primary terms are issued in deep water, they are not covered by the proposed rule, because MMS believes that 10 years is sufficient to explore and develop these deep prospects.

Amendments to Federal Natural Gas Valuation Rule Finalized

Amendments to the 1988 Federal Gas Valuation Rule make Federal natural gas leases more attractive for development, and provide assurance of a fair market return on these resources to the American public. Final amendments to the rule, used to determine royalties due on natural gas from Federal leases, were published in the Federal Register on March 10, 2005, and effective June 1, 2005. Throughout the development of this rule, MMS held public workshops to gather feedback, which was incorporated into the final rulemaking. The changes offer greater certainty, clarity, consistency and more accurate royalty reporting on natural gas valuation issues ultimately helping MMS to assure economic value for America.

Royalty in Kind (RIK)

The RIK program has become an integral part of the approach to managing mineral royalties. This has included selling oil and gas in the marketplace and disbursing resulting revenues as prescribed by law, or transferring resources to fill the Nation's Strategic Petroleum Reserve (SPR). Among the objectives of the RIK program are to return a fair value on the public's royalty assets, reduce regulatory costs and reporting requirements, shorten the compliance cycle, and improve overall business efficiencies. In addition, taking royalties "in-kind" in the form of oil and gas simplifies audits and reduces conflict and litigation associated with valuation of mineral royalties.

In 2004, MMS released the Five-Year RIK Business Plan for FY 2005 to FY 2009. This plan increases MMS's ability to implement conservative business principles that will enhance royalty asset management and maximize returns to the taxpayer. The RIK program demonstrated it can, and will continue to, provide reduced administrative costs with optimized royalty revenue.

The Energy Policy Act of 2005 provides additional tools to the Federal Government to enhance the RIK program, provided the Secretary determines that receiving royalties in-kind provides benefits to the United States greater than or equal to those that it would have received in-value.

RIK Generates Solid, Measurable Returns

When economic and financial analysis clearly indicates that there is economic advantage to the Government, (e.g. increased revenues, greater administrative efficiency, and/or security needs of the Nation) MMS will collect royalties in-kind. Sales of royalty oil and gas through MMS's RIK program generated more than $18 million in additional revenue for the U.S. Treasury in FY 2004. This is an increase in revenue above estimates of what would have been received if the Government had taken the oil and gas royalties in value, or as cash payments. In addition to revenue gains of $17.2 million in natural gas and oil sales, an additional gain of nearly $900,000 was achieved through incremental interest earned on revenues received 5 to 10 days earlier than under the royalty-in-value program. In the area of gas sales, 13 of the 15 portfolios demonstrated revenue gains. Within the four oil sales conducted in FY 2004, all showed revenue gains. The returns are generally consistent with past reviews that showed MMS is achieving revenue increases of generally 1 to 3 percent more than would have been received through royalty-in-value receipts.

Managing RIK Credit Exposure and Risk

During FY 2005, MMS established a RIK internal control and performance/risk monitoring framework. Implementing asset management strategies requires an understanding of the risks and rewards associated with each strategy and its potential impact on the organization. To support the RIK operational program and MMS policy oversight functions, it is important to develop a performance/risk monitoring framework that reflects MMS's business objectives. A conceptual framework has been developed that can qualitatively monitor and measure the combined impact of the Risk, Reward and Control ("RRC") parameters in relation to the risk drivers of the RIK program. The different exposures in the RIK program can be classified into four main risk categories: market risk, operational risk, credit risk, and oversight risk.

Completed Strategic Petroleum Reserve Fill Initiative

The Strategic Petroleum Reserve (SPR) is the world's largest supply of emergency crude oil, with the Federally owned oil stocks stored in huge underground salt caverns along the coastline of the Gulf of Mexico. The MMS and the Department of Energy (DOE) began a fill initiative in April 2002, in response to a 2001 Presidential directive. During 2005, MMS completed delivery of in-kind oil to fill the SPR to 700 million barrels, as directed.

The exchange contracts between MMS and the DOE involved aggregation of crude oil royalties taken "in-kind" (in the form of oil), rather than in value (cash), from offshore Federal lease operators in the Gulf of Mexico. That oil is delivered to DOE at onshore market centers, where DOE enters into additional exchanges for crude oil of suitable quality delivered to SPR sites in Texas and Louisiana. Completing the initiative to fill the SPR helps the Nation meet its commitment to maintain emergency oil stocks and support national objectives for energy security.

The Energy Policy Act of 2005 authorizes the Secretary of Energy to fill the SPR to a one billion barrel capacity. After additional underground salt caverns are created, the SPR royalty oil will likely come from offshore operations in the Gulf of Mexico.

Enhancing American Indian Services

The MMS is a steward of the royalty asset from Indian trust properties and serves as an advocate for the interests of Indian mineral owners, ensuring fulfillment of our Indian trust responsibility. The MMS annually expends more than 20 percent of its resources toward managing revenues from Indian lands, while Indian revenues only account for about 3 percent of the total mineral revenues. The continuing objective of MMS is to provide the highest possible Indian trust service relative to our role in collecting and disbursing royalties from Indian lands to 35 tribes and to an estimated 30,000 individual Indian mineral owners (IIMOs). The MMS focuses its efforts on the accuracy and timeliness of collections and disbursements of Indian mineral revenues, as well as on industry compliance, to ensure that Indian tribes and IIMOs receive all money they are due.

Workshops and Consultations on Proposed Indian Oil Valuation Rule

Information gathered from three public workshops in March and five consultations in June, with Indian tribal leaders and individual Indian mineral owners, is being used by MMS to develop a new proposed rule regarding Indian oil royalty valuation. The sessions provided preliminary comments and discussion opportunities in anticipation of publishing a draft new proposed Indian Oil Valuation Rule in January 2006. A final rule is expected in late 2006. The new rulemaking will replace the existing 1988 Indian Oil Valuation Rule and will focus on establishing fair market value, encouraging continued exploration and development on Indian lands, complying with the unique Indian lease terms, and protecting the Indian Trust asset with long-term economic benefits and sustainability.

Outreach with American Indian Constituents

The MMS uses several outreach methods, such as Navajo radio broadcasts and attending pow-wows, to reach the American Indian constituents. This reflects MMS's goal to fulfill the Secretary of the Interior's trust responsibility to American Indians. The outreach is designed to resolve their royalty-related problems and to let them know how to contact MMS. These meetings enable MMS to listen to their concerns and suggestions for royalty accounting improvements, answer questions, identify and resolve mineral-related problems in partnership with BIA, BLM, and the Office of Special Trustee. The MMS's goal is to enhance trust responsibility and foster a positive working relationship with the Indian community. During FY 2005, MMS held 84 outreach sessions with American Indian constituents and resolved 5,247 royalty-related inquiries.

Presidential Management Agenda Scorecard

During FY 2005, MMS improved performance in areas targeted by the President's Management Agenda (PMA). This progress is evident when comparing the Bureau's self-assessment scorecards, for the five PMA areas for which it is responsible, during the last rating period for FY 2004 and the FY 2005 rating period. MMS is responsible for improving performance within the areas of: Human Capital; Competitive Sourcing; Financial Management; E-Government; and Budget and Performance Integration. The following paragraph briefly describes MMS's performance status within each area.

MMS's performance achievements throughout FY 2005 resulted in a "green" rating, a score of 7-9 on a scale of 10, within four of the five PMA areas. Performance scores increased in the areas of Human Capital, Competitive Sourcing, E-Government and Financial Management. Although the budget and performance integration performance score slightly decreased between FY 2004 and FY 2005, MMS maintained a green rating. Additionally, despite maintaining the performance score of 18, the Financial Management status slipped from green to yellow due to more stringent rating requirements.

MMS's scorecard ratings are depicted in the below table.

PMA Areas	MMS FY 2004 PMA Scorecards May 2004	MMS FY 2005 PMA Scorecards October 2005
Human Capital	**7.6**	**8.2**
Competitive Sourcing	**7.9**	**8.3**
Financial Management*	**18.0**	**18.0****
E-Government	**7.0**	**8.3**
Budget and Performance Integration	**8.0**	**7.0**

* *The Financial Management PMA Scorecard uses a different rating system than the other Scorecards.*

** *Rating criteria for this Scorecard changed for the Spring 2005 rating period, to be consistent with the FY 2005 rating process.*

Interior Franchise Fund

The IFF goal is to achieve an annual growth rate of 10 percent in the dollar value of Contracts Awarded and Funds Received.

- The Value of Contracts Awarded measures productive output of the IFF.
- Funds Received is generally considered an indicator of the effectiveness of sales and marketing efforts to expand the business base.

IFF Measure	FY 2002	FY 2003	FY 2004	FY 2005	Change from FY 2004 to FY 2005
Contracts Awarded	$.480B	$1.884B	$1.539B	$1.421B	-7.6%
Funds Received	$.824B	$1.730B	$1.615B	$1.366B	-15.42%

During FY 2005 DOI management announced its intent to transfer the IFF to the Department's National Business Center (NBC). In order to focus its resources on a successful transfer and allow time for the development of a staff to sustain the organization, management made the decision to limit growth during FY 2005.

LOOKING AHEAD - MANAGEMENT CHALLENGES

Although the oil and gas industry is a globally competitive business, oil production from the Federal OCS now accounts for 30 percent of total domestic production – more than double what it was just 12 years ago. With an eye on the future, MMS is actively involved in providing access to energy resources for the American people, from traditional sources such as oil and natural gas, as well as renewable sources of energy on the OCS. MMS ensures the public receives the maximum benefit from these resources through the collection, accounting, and disbursement of revenues from mineral leases on OCS, Federal and American Indian lands.

"Although a number of different variables have to be taken into consideration in crafting a regime for other ocean uses, the scope and comprehensiveness of the OCS oil and gas program can be a model for the management of a wide variety of offshore activities."

Pg. 290 An Ocean Blueprint for the 21st Century, Final Report of the U.S. Commission on Ocean Policy, July 22, 2004.

Disruptions due to Hurricanes Katrina and Rita

The entire Gulf of Mexico Region was severely impacted by Hurricanes Katrina and Rita. One third of the bureau's 1,700 employees reside in the Gulf of Mexico region affected by the hurricanes. Many employees were displaced from their homes; the (leased) New Orleans Regional headquarters and New Orleans and Lake Charles District Office buildings sustained water and wind damage. The MMS established a temporary office in Houston under its Continuity of Operations Plan. The GOM Region currently has 150 employees working from the temporary office.

MMS continues to support the rebuilding of offshore oil and gas infrastructure by providing expeditious review for critical industry applications. To support this effort, MMS has requested by Notice to Lessees (NTL) that industry delay the reporting of routine data until after January 1, 2006, due to the reduced workforce. By publication of a final rule in the Federal Register, MMS granted an extension to affected companies to pay royalties owed on Federal oil and gas leases. The new date for royalties due and corresponding royalty reports for the production months of July, August, September, and October 2005 is January 3, 2006. MMS will continue to fulfill its regulatory responsibilities and expects to maintain timely review of industry submittals through the temporary Houston office, or other alternative arrangements, such as assigning some aspects of the work to staff at other locations.

Ensuring the Safety of an Aging Infrastructure

The average age of all current OCS platforms is about 20 years. If not properly maintained, offshore oil and gas facilities and components age at an accelerated rate due to the corrosive salt-water environment. In order to have this infrastructure in safe and useful condition for years to come, it is important to properly protect and maintain wells, platforms, and pipelines through sound engineering standards and rigorous inspection. The MMS is working closely with industry to ensure the continued safety of OCS facilities, protecting both workers and the environment.

Implementing the Energy Policy Act of 2005 to Meet Increasing Energy Demand

With increasing pressures on the energy markets, high commodity prices, and continuing dependence on foreign oil supplies, the United States is facing new opportunities, as well as challenges, to meet the demand for additional domestic energy. Given the limited area available for hydrocarbon leases in the Gulf of Mexico and offshore Alaska, the oil and gas industry is moving into deeper waters of the Outer Continental Shelf (OCS). The expanding deepwater frontier brings with it unique challenges to MMS, including more complicated environmental assessments, the need for new scientific research, and increasing operational complexities. MMS is also helping the country meet energy demands through production incentives and with its new authority over renewable sources of energy.

Managing access to the OCS is becoming more complicated, with aquaculture, wind and wave power, hazard areas, artificial reefs, sand borrow sites, shipping, fishing, liquefied natural gas (LNG) ports and fiber optic cables competing for limited space. These projects present MMS with increasingly complicated multiple-use and primacy issues. The MMS may need to re-evaluate environmental impact analyses and develop new lease stipulations and operating conditions, as alternative uses on the OCS continue to expand. MMS expects to increase its coordination and consultation efforts to ensure that the DOI/MMS mineral resource domain remains accessible, that MMS-granted energy and non-energy rights are protected, and that OCS related activities continue to be conducted in a safe and environmentally-sound manner.

The Energy Policy Act of 2005 provides MMS several new authorities and programs to implement. The MMS will integrate these new responsibilities into our organization, while continuing to protect the environment, lives, and property and ensure fair value for America's resources. Key provisions of the Act affecting MMS include:

> *"I am very pleased with the passage of this energy bill which promotes the development of renewable energy sources and provides new avenues for us to help provide safe, secure and environmentally sound energy for America."*
>
> R. M. "Johnnie" Burton
> MMS Director

- Provides incentives for natural gas production from deep wells in the shallow waters of the Gulf of Mexico and extends deep-water royalty relief for five years.
- Provides Alaska offshore royalty suspension at the Secretary's discretion in order to encourage production.
- Provides new authority to regulate alternative energy-related uses on the Outer Continental Shelf and provides for a 27 percent sharing of any royalties, bonuses, and rentals for these projects within three nautical miles seaward of State waters.
- The act implements a new Coastal Impact Assistance Program, providing $250 million per year for FY 2007 through FY 2010 to six energy-producing States in a formula based upon each State's proximity to production, population and length of coastline. These states: Louisiana, Texas, Mississippi, Alabama, Alaska and California will be able to use this funding for approved coastal restoration and conservation purposes.
- Directs the Department of the Interior to perform both a comprehensive inventory of oil and gas resources on the Outer Continental Shelf and an assessment of renewable energy potential on Federal lands and the OCS. These assessments will help the Nation better understand the resource potential of the Outer Continental Shelf.
- Updates the Geothermal Steam Act by amending the leasing provisions to provide for a competitive leasing system. Also directs other actions that will facilitate new development of geothermal resources, including a new royalty structure.

Diversifying the RIK Business Model

The Five-Year RIK Business Plan provides for further development of RIK functions and capabilities to increase the value to constituents. The MMS must move the RIK business model to the more active position required to increase net revenues. For optimal portfolio performance, MMS must have expertise to evaluate various marketing alternatives and continuously monitor historical and forward-looking market intelligence pertaining to the alternatives. This will require enhanced commercial expertise to ensure optimal implementation of diversified marketing and sales strategies. In order to assess the risks and rewards associated with each marketing strategy and its potential impact on the portfolio, expertise is required in marketing, quantitative analysis, commercial contracting, and commercial legal advice.

DISCUSSION AND ANALYSIS OF THE FINANCIAL STATEMENTS

The MMS prepares annual Financial Statements to help fulfill its responsibility to be publicly accountable, and to manage its programs efficiently and effectively. The MMS's principal Financial Statements include the consolidated balance sheet, consolidated statements of net cost, consolidated statement of changes in net position, consolidated statement of financing, combined statement of budgetary resources, and statement of custodial activity.

To provide greater assurance on the integrity of financial operations and the accuracy of financial data, MMS undergoes annual Financial Statement audits. The MMS's goals are to obtain an unqualified audit opinion on its Financial Statements, eliminate findings related to the internal control environment, and ensure the Bureau does not have instances of non-compliance with provisions of laws and regulations that have a direct and material impact on the Financial Statements. The MMS obtained an unqualified opinion on its Financial Statements in FY 2005 and FY 2004. While MMS has made significant progress in enhancing its overall control environment we have not been able to eliminate all instances of reportable conditions or non-compliance with applicable laws and regulations.

Limitation of Financial Statements

Responsibility for the integrity and objectivity of the Financial Statements lies with MMS management. The Financial Statements and supplementary schedules included in the report reflect the financial position and results of operations of MMS pursuant to the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. While the statements are prepared from the books and records of the Bureau in accordance with accounting principles generally accepted in the United States for Federal entities and the formats prescribed by OMB, the statements differ from financial reports used to monitor and control budgetary resources 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 the enactment of an appropriation, and ongoing operations are subject to the enactment of appropriations.

General

Statement of Net Cost and the Strategic Plan

In accordance with OMB Circular A-136*,* MMS aligned its Statement of Net Cost directly to the goals and outcomes identified in the Department of Interior Strategic Plan. As required by the Government Performance Results Act (GPRA), the Department updated its departmentwide strategic plan in FY 2004. Under the updated Strategic Plan, the mission goals and categories for MMS are as follows:

1. Resource Use
2. Serving Communities
3. Reimbursable Activity and Other

Interior Franchise Fund

Realignment

The Secretary of the Interior issued an order dated September 29, 2005 indicating management's decision to transfer the Interior Franchise Fund, including the appropriate personnel, funds, records, and property, from the Minerals Management Service to Departmental Offices on October 2, 2005.

Statement of Federal Financial Accounting Concept No. 2, *Entity and Display*, indicates that any organization, program, or budget account included in an entity's section of the President's Budget should be considered part of the organization with which it appears (i.e., conclusive criterion). In addition, OMB Circular A-136, *Financial Reporting Requirements*, indicates that OMB approval shall be obtained for exemptions to the conclusive criterion.

Interior Franchise Fund appears as part of the Minerals Management Service's section of the President's Budget and does not appear as part of Departmental Office's section of the President's Budget. As a result, management is working with OMB to obtain approval for the transfer of Interior Franchise Fund from Minerals Management Service to Departmental Offices; however, Minerals Management Service has not received approval from OMB. Until the Minerals Management Service receives approval from OMB, the Minerals Management Service will continue to report the Interior Franchise Fund as part of its reporting entity.

Going Concern

The Interior Franchise Fund currently operates under temporary authorizing legislation that normally expires October 1st of each year. Section 632 of Title VI within the General Provisions of the 2006 Presidents budget extends the sunset date to October 1, 2006. The existence of the sunset date creates uncertainties about the IFF's ability to continue as a going concern because of the dependency on the annual renewal of its authorizing legislation.

Management's plan with respect to the uncertainty discussed above is to work with Departmental Offices to obtain final approval for the transfer and to continue its non-IFF funds and programs. Should the transfer be unsuccessful MMS will continue to operate the IFF and will seek additional wording in the FY 2007 appropriation language that establishes franchising as a permanent program or provides franchise-like authority permanently. If the IFF remains with MMS and the plan to obtain extended or permanent authorization are unsuccessful, MMS will no longer offer services under IFF and instead offer the same services under the authority of the Economy Act and adjust its pricing conventions to eliminate retained earnings.

Operating Challenges

Fiscal year 2005 presented a number of important challenges that affected MMS's financial position and results of operations. The most significant of these were the planned realignment of the Interior Franchise Fund, increased royalty and related collections and distributions caused by higher oil and gas prices and production volume, and the development of alternative processes to accurately report on oil and gas production for those companies affected by Hurricanes Katrina and Rita.

Costs of Operations

As reflected on the Consolidated Statement of Net Cost, the total FY 2005 net cost of MMS operations was $2.41 billion, an increase of approximately $902 million from the FY 2004 net cost of $1.51 billion. The increase is primarily attributable to a $729 million increase in royalty collections that are paid to the States, and a $182 million increase in IFF reimbursable expenses attributable to increased business volume, primarily with the Department of Defense, for acquisition, personnel, and other technical services.

Revenues

In general, MMS's strategic goals are intended to be funded by general government funds derived from tax receipts and other sources. However, other fees and collections support a number of MMS activities. As authorized by Congress, MMS collected approximately $129 million in revenues during FY 2005 from the public as royalties, rents, and bonus receipts. Additionally, MMS earned approximately $1,533 million in revenue in fiscal year 2005, an increase over FY 2004 of approximately $178 million. This increase, as discussed under the costs of operations, is attributable to increased amounts collected from other Federal entities for IFF services.

Assets

The MMS's Consolidated Balance Sheet shows FY 2005 assets totaling $5,393 million, an increase of $1,385 million from FY 2004. Although MMS experienced a decrease of $58 million in advances received from others for activity within the IFF, MMS had increases in Custodial Accounts Receivable of $792 million and Administrative Accounts Receivable of $595 million. The increases are due to an increase in receivable due on long term deferred bonuses for on-shore solid mineral lease sales and an increase in receivables related to increased oil and gas production.

Budgetary Resources

The MMS's major sources of budgetary resources consist of direct appropriations and offsetting collections. The MMS's FY 2005 budgetary resources of $4,204 million consisted of approximately $1,639 million or 39 percent of offsetting collections, $1,809 million or 43 percent of appropriations received, and $749 million or 18 percent of Unobligated Balances brought forward from prior years. Of the total budgetary resources, $3,399 million were obligated in FY 2005.

In FY 2005 total budgetary resources increased from $3,791 million to $4,204 million. The increase is primarily the result of a $457 million increase in appropriations received for lease sales and oil and gas royalty collections that will ultimately be distributed to the states.

The MMS's mission critical operations are funded from three sources: the Royalty and Offshore Minerals Management (ROMM) appropriation, Oil Spill Research, and offsetting collections received primarily from rental receipts from offshore leases. For FY 2005, the MMS had total annual appropriated resources of $273.1 million, of which $103.7 million was from offsetting collections.

Custodial Accounts

The MMS's custodial revenues are from Outer Continental Shelf and onshore oil, gas, and mineral lease sales and royalties. These revenues are presented on MMS's Statement of Custodial Activity, not on its Statement of Net Cost or Statement of Changes in Net Position because they are considered to be revenue of the Government as a whole rather than to MMS or the Department. Revenues are collected on behalf of the U.S. Treasury, other Federal agencies, States, Indian Tribes, and Individual Indian Allottees.

In FY 2005 MMS had custodial revenues of approximately $12,382 million, an increase of approximately $3,132 million from FY 2004. The sharp increase is attributable to an increase of onshore solid mineral lease sales of $1,275 million, and increased royalty collections of $1,854 million. Lease sales have increased because of an increase in the number of on-shore lease sales and higher bids for on-shore lease sales. Royalty collections have increased due to a combination of higher oil and gas prices and increased volume by producers.

Liabilities and Net Position

Federal agencies, by law, cannot make payments unless Congress has appropriated funds. The MMS's unfunded liabilities excluding the accrued liability to the States, and custodial liabilities for oil and gas leases and royalties payable is approximately $574 million. The $574 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 Unexpended Appropriations, Cumulative Results of Operations for Administrative and the Environmental Improvement Restoration Fund (EIRF). The MMS's Net Position as of September 30, 2005, is $594 million, which consists of $8.6 million of Unexpended Appropriations, a deficit of $446 million in Administrative Cumulative Results of Operations and $1,031 million in the EIRF Cumulative Results of Operations.

The Unexpended Appropriations represent 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, 2005, due to a legal contingent liability that has been accrued for. It is legal counsel's opinion that ultimately any liability associated with this case will be funded by the Department of Justice's Judgment fund, at which time MMS will recognize revenue, 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.

COMPLIANCE WITH LAWS, SYSTEMS, CONTROLS, AND FINANCIAL PERFORMANCE

Compliance With Laws

MMS is required to comply with several key legal and regulatory financial requirements, including the Prompt Payment Act, the Debt Collection Improvement Act, the Improper Payments Information Act, the Inspector General Act Amendments (Audit Follow-Up), the Federal Oil and Gas Royalty Management Act, the Federal Managers' Financial Integrity Act (FMFIA), and the Federal Financial Management Improvement Act (FFMIA).

Based on the results of the FY 2005 independent audit of the financial statements, MMS was determined to be non-compliant with the Debt Collection Improvement Act.

Federal Financial Management Improvement Act (FFMIA)

As of September 30, 2005 MMS financial management systems complied substantially with the U.S. Standard General Ledger (USSGL) at the Transaction Level, financial management systems requirements, and accounting standards applicable to Federal entities.

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 Associate Directors maintains responsibility for effective controls to provide reasonable assurance that Government resources are protected against fraud, waste, abuse, mismanagement, or misappropriation.

Audit Follow-Up

During fiscal year 2005, MMS made significant progress in implementing processes and procedures to correct findings identified during previous audits. While considerable effort and resources have been expended, and most findings from previous audits have been corrected, MMS has not yet completed its efforts to eliminate previous findings or non-compliances related to system and application controls, and accounts receivable.

Improper Payments Information Act

The Improper Payments Information Act (IPIA) of 2002 (P.L. 107-300) requires Federal agencies to carry out a cost-effective program for identifying payment errors and recovering any amounts overpaid. An improper (or erroneous) payment includes any payment that should not have been made, or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement. Incorrect amounts include: overpayments; underpayments (including inappropriate denials of payment or service); any payment made to an ineligible recipient or for an ineligible service; duplicate payments; payments for services not received; and payments that do not account for credit for applicable discounts.

To implement IPIA, the Office of Management and Budget (OMB) required agencies to review all programs (meeting OMB's definition of "program") to determine the risk susceptibility of making improper payments and to perform more in-depth assessments for those programs meeting OMB's criteria for "significant erroneous payments", defined as annual erroneous payments in the program exceeding both 2.5 percent of program payments and $10 million.

Based on management analysis and a series of internal control review techniques, MMS determined that none of its programs are risk-susceptible for making significant improper payments at or above the threshold levels set by OMB. It should be noted that these reviews were conducted in addition to audits under the Chief Financial Officers Act of 1990, GAO reviews, and reviews by Interior's Inspector General. Three different techniques were used to arrive at this determination: (1) risk assessments of internal controls related to payments for all programs using the thresholds set out above; (2) Departmental Functional Reviews (DFRs) focusing on the general control environment for making payments and the controls related to specific payment types; and (3) post-payment recovery audits. Each of the three techniques is summarized below:

1. Risk Assessments. Under Departmental Management Control Guidance for FY 2005 MMS conducted risk assessments of all programs to determine if any were risk-susceptible for making significant improper payments. The assessments were used to establish risk profiles for all bureau programs. As a result of these reviews, MMS came to the conclusion that none of its programs pose a high-risk of making significant improper payments based on OMB's criteria.

2. Department-Wide Functional Reviews (DFRs). Under Departmental guidance MMS conducted DFRs in FY 2005 for the following payment processes: vendor, travel, and purchase card. The results of the DFRs indicated that internal controls were adequate and working as intended in the vendor, travel, and purchase card processes.

3. *Recovery Audits* - In response to Section 831 of the Defense Authorization Act for FY 2002 (U.S. Code 31 USC 3561-3567), Interior contracted with a recovery audit firm that began work in FY 2004.

MMS Plans for FY 2006 – FY 2007. Annual goals are to maintain adequate controls over payment processes to ensure that erroneous payments are minimized. The MMS will continue using contractor assistance to perform post-payment recovery audits initiated in FY 2004.

Financial Systems

Currently MMS relies on a set of financial management systems to collectively support program and financial managers. Systems are managed at various levels within MMS ranging from bureau level centrally managed systems, locally managed systems, and externally managed systems upon which MMS relies. Collectively these systems represent MMS's financial management systems architecture.

In alignment with the views of the government-wide CFO council, MMS believes that the key to improved program and financial management is improved financial management systems. To meet the need for improved systems MMS has fully aligned with a department wide initiative to implement the Financial and Business Management System (FBMS).

Management Controls

MMS's management control program is designed to ensure compliance with the goals, objectives, and requirements of the FMFIA and Office of Management and Budget (OMB) Circular A-123, "*Management Accountability and Control,*" Circular A-127, *"Financial Systems,"* and OMB Circular A-130, "Management of Federal Information Resources."

MMS believes that in addition to reoccurring controls within each of its significant business processes, the key to sound internal control is cognizance of the overall control environment by all levels of management, and the communication of management's emphasis on the importance of a sound control environment. As part of its overall control program, MMS has implemented a comprehensive management review program to include Administrative Management Assistance Reviews, Department-Wide Functional Reviews, and Risk Assessments of its major programs.

Financial Performance

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.

2005 Results: The MMS paid 97 percent of all payments without interest penalty in FY 2005.

Performance Measure: To use Electronic Funds Transfer (EFT) to the maximum extent possible when making payments, in-order to exceed the government wide goal of 90 percent.

2005 Results: The MMS achieved its goal by continuing to require new vendors and employees to enroll for EFT payments. During FY 2005, 99.88 percent of all payments were made via EFT.

Performance Measure: To identify and refer 95 percent of delinquent debt to Treasury when 180 days past due.

2005 Results: The MMS met this goal by identifying and referring 99.99 percent of eligible delinquent debt to Treasury when 180 days past due.

Performance Measure: To reduce the delinquency rate of employee individually billed travel charge card accounts past due 61+ days to 1 percent or less.

2005 Results: The MMS met this goal by maintaining an average delinquency rate of .99 percent of employee individually billed travel charges.

Crane at work

Independent Auditors' Report

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

December 8, 2005

Memorandum

To: Director, Minerals Management Service

From: Anne L. Richards
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Minerals Management Service's Financial Statements for Fiscal Years 2005 and 2004 (Report No. X-IN-MMS-0010-2005)

Attached is the subject auditors' report prepared by KPMG LLP (Attachment 1). It contains an unqualified opinion on the Minerals Management Service's (MMS) financial statements. However, KPMG identified two reportable conditions on MMS's internal controls over financial reporting. In addition, KPMG found instances in which MMS did not comply with the Debt Collection Improvement Act of 1996.

The Department of the Interior contracted with KPMG, an independent certified public accounting firm, to audit MMS's financial statements for fiscal years 2005 and 2004. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget's Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency's *Financial Audit Manual.*

KPMG is responsible for the auditors' report and for the conclusions expressed in the report. We do not express an opinion on MMS's financial statements, KPMG's conclusions on the effectiveness of internal controls, conclusions on whether MMS's financial management systems substantially complied with the Federal Financial Management Improvement Act of 1996, or conclusions on compliance with laws and regulations.

In its November 18, 2005 response to the draft auditors' report (Attachment 2), MMS concurred with the findings and recommendations. Based on the response, we consider the report's recommendations resolved but not implemented, and we will refer them to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, 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 regarding the report, please contact me at (202) 208-5512.

Attachments (2)

cc: Assistant Secretary, Land and Minerals Management
Chief Financial Officer, Minerals Management Service
Director, Office of Financial Management
Audit Liaison Officer, Office of Financial Management
Audit Liaison Officer, Land and Minerals Management
Audit Liaison Officer, Minerals Management Service
Focus Leader for Financial Reporting, Office of Financial Management
Focus Leader for Management Control and Audit Followup,
Office of Financial Management

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of Minerals Management Service (MMS) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, 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 (hereinafter referred to as the 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, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that the Minerals Management Service financial statements as of and for the years ended September 30, 2005 and 2004, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, MMS adopted the provisions of Federal Accounting Standards Advisory Board Interpretation No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4,* effective October 1, 2004.

MMS prepared the accompanying financial statements assuming that the Interior Franchise Fund will continue as a going concern. As discussed in Note 1.1 to the financial statements, the expiration of the Interior Franchise Fund's authorizing legislation on October 1, 2006 creates an uncertainty about MMS's ability to continue as a going concern. Management plans regarding this matter are also described in Note 1.1. 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 resulted in the following conditions being identified as reportable conditions:

A. General and Application Controls over Financial Management Systems

B. Controls over Accounts and Interest Receivable

However, none of the reportable conditions are believed to be material weaknesses.

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

C. Debt Collection Improvement Act of 1996

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, regulations, contracts, and grant agreements, 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, 2005 and 2004, and the related consolidated statements of net cost, 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, 2005 and 2004, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activities, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, MMS adopted the provisions of Federal Accounting Standards Advisory Board Interpretation No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4,* effective October 1, 2004.

MMS prepared the accompanying financial statements assuming that the Interior Franchise Fund will continue as a going concern. As discussed in Note 1.1 to the financial statements, the expiration of the Interior Franchise Fund's authorizing legislation on October 1, 2006 creates an uncertainty about MMS's ability to continue as a going concern. Management plans regarding this matter are also described in Note 1.1. 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 Information, and Required Supplementary Stewardship 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 Circular A-136, *Financial Reporting Requirements*, Part A, *Form and Content of the Performance and Accountability Report.* We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect 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 2005 audit, we noted certain matters, described below, involving internal control over financial reporting and its operation that we consider to be reportable conditions. However, none of the reportable conditions are believed to be material weaknesses.

A. General and Application Controls over Financial Management Systems

MMS did not have adequate information technology 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*

MMS has a security monitoring and reporting program; however, MMS's security monitoring and reporting process did not include all information systems, platforms and components. In addition, MMS has documented its physical security program for its operations facility; however, MMS has not finalized and approved the plan.

2. *Access Controls*

MMS did not have a formally documented process for granting access to certain financial applications. In addition, MMS did not consistently maintain user access forms and allowed certain users to have duplicate accounts for systems and applications. Additionally, MMS did not consistently remove access of terminated employees from the systems and applications in a timely manner or consistently prepare the required exit clearance documentation prior to an employee's departure. Although MMS represented that it performs periodic reviews over systems and applications, MMS did not maintain evidence that MMS consistently performed these reviews to ensure that all users are authorized, the level of access rights are commensurate with each user's responsibilities, and there are not any duplicate user accounts.

MMS had not developed or implemented a policy that requires management to monitor security violations and inactive accounts. In addition, MMS did not consistently generate security and activity logs for its systems and applications. Furthermore, the financial applications were not configured to prepare logs for security profile changes; therefore, MMS did not effectively review and approve security profile changes.

3. *System Software Controls*

MMS had not formally documented policies and procedures for restricting and monitoring access to system software, identifying system software issues, changes to system software, or reviewing event logs. In addition, MMS did not consistently monitor the use of operating system software. Although MMS reviewed event logs, MMS did not maintain evidence that the reviews were completed. Additionally, MMS did not have controls in place to prevent system software from for one of its applications. MMS also had not fully documented its service continuity procedures or full being installed without management approval.

4. *Software Development and Change Controls*

   MMS had not formally developed, documented, or implemented data processing procedures to control and standardize the maintenance of two financial applications. In addition, MMS did not use library management software to control changes to the accounting system and shared manager and account level passwords among several users. Furthermore, MMS's system configurations did not adequately segregate duties as the configurations provided individuals, who are involved with programming and migrating changes to production, access to the source code, test, and production libraries.

5. *Service Continuity*

   MMS had not developed and documented a comprehensive contingency and disaster recovery plan for one of its applications. MMS also had not fully documented its service continuity procedures or fully trained team members for emergency response. In addition, MMS did not test all of its contingency and disaster recovery or continuity of operations plans. Additionally, MMS did not consistently prepare daily and monthly backup files and did not test the backup files for certain financial applications. Furthermore, MMS did not have current maintenance agreements for all of its computer and related equipment and should consider improving the location of plumbing lines and adding secondary air conditioning for the computer room.

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.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

B. Controls over Accounts and Interest Receivable

MMS needs to improve controls over accounts receivable to ensure that transactions are promptly and properly recorded for timely and reliable financial reports:

1. *Royalty Receivables*

   Although MMS investigated and resolved certain aged and credit balances in the custodial accounts receivable subsidiary ledger over the past year, MMS needs to continue investigating and resolving the aged and credit balances. MMS did not perform follow up procedures in the past two years or write-off the balances in a timely manner for 16 of the 32 aged balances that we tested. In addition, MMS had approximately $98 million of accounts receivable that were over one year old and fully reserved for as of September 30, 2005. Furthermore, MMS had approximately $66 million of credit balances that were over 30 days old, including approximately $23 million of credits that are over one year old as of September 30, 2005.

2. *Debt Referral*

MMS did not have adequate controls to ensure that delinquent receivables were properly identified for referral to the U.S. Department of the Treasury (Treasury) for collection or offset in a timely manner. Specifically, MMS did not place on hold or refer to Treasury for collection or offset 9 of the 32 receivables that we tested in a timely manner.

Recommendation

We recommend that MMS complete the following in fiscal year 2006:

1. *Royalty Receivables*

   Continue to analyze and resolve aged and credit accounts receivable balances.

2. *Debt Referral*

   Implement controls to ensure timely referral of delinquent debt to Treasury.

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

A summary of the status of prior year reportable conditions is included as Exhibit I. We also noted certain additional matters that we reported to the management of MMS in a separate letter dated November 14, 2005.

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and is described below.

C. Debt Collection Improvement Act of 1996

In accordance with the *Debt Collection Improvement Act of 1996*, MMS is required to refer eligible receivables that are delinquent to the Treasury for collection or offset. Eligible receivables include those that are over 180 days delinquent and not the subject of litigation, related to foreclosure proceedings, or from organizations in bankruptcy. MMS did not have adequate controls to ensure that MMS consistently identified delinquent receivables eligible for referral to the Treasury in a timely manner. MMS has over $79 million of receivables that were over 180 days past due as of September 30, 2005.

Recommendation

We recommend that in fiscal year 2006, MMS establish a process to ensure eligible receivables are referred to the U.S. Department of the Treasury in a timely manner

Management Response

Management has prepared an official response presented as a separate attachment to this report. In summary, management agreed with our findings and its comments were responsive to our recommendations.

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

RESPONSIBILITIES

Management's Responsibilities. The *Government Management Reform Act of 1994* (GMRA), *Accountability of Tax Dollars Act, and Government Corporation Control Act* require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To assist the U.S. Department of the Interior in meeting the GMRA reporting requirements, MMS prepares annual financial statements in accordance with Part A of OMB Circular A-136.

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information;
- Establishing and maintaining internal controls over financial reporting; and
- Complying with laws, regulations, contracts, and grant agreements, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies. 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 2005 and 2004 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MMS's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

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

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

KPMG

In planning and performing our fiscal year 2005 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 *Government Auditing Standards* and OMB Bulletin No. 01-02. 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 MMS's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, we considered MMS's internal control over the 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 the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis and Performance sections, 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 reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether MMS's fiscal year 2005 financial statements are free of material misstatement, we performed tests of MMS's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of 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, regulations, contracts, and grant agreements applicable to MMS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 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 solely for the information and use of MMS's management, the U.S. Department of the Interior Office of Inspector General, OMB, the Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 14, 2005

Exhibit I

MINERALS MANAGEMENT SERVICE

Summary of the Status of Prior Year Findings

September 30, 2005

Ref	Condition	Status
A	Controls Over the Year-end Closing Process	This condition has been corrected.
B	General and Application Controls over Financial Management Systems	This condition has not been corrected and is repeated in fiscal year 2005. See finding A.
C	Accounts and Interest Receivable	This condition has not been corrected and is repeated in fiscal year 2005. See finding B.
D	Prompt Payment Act	This condition has been corrected.
E	Debt Collection Improvement Act of 1996	This condition has not been corrected and is repeated in fiscal year 2005. See finding C.
F	*Federal Financial Management Improvement Act of 1996 (FFMIA)*	This condition has been corrected.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

NOV 1 8 200

Anne L. Richards
Assistant Inspector General for Audits
U.S. Department of the Interior
Office of Inspector General
1849 C Street, NW, MS5341
Washington, D.C. 20240

Mr. Jeff Norris
c/o KPMG LLP
2001 M St., NW
Washington, D.C. 20036

Dear Ms. Richards and Mr. Norris:

Thank you for the opportunity to respond to the independent auditors' (KPMG) report on MMS's financial statements for Fiscal Years 2005 and 2004. We concur with the independent auditors' findings of two reportable conditions related to internal controls and financial operations and one instance of non-compliance with laws and regulations applicable to MMS. Enclosed are our specific comments on the identified recommendations.

Please contact Scott L. Mabry at 703-787-1243 if you have any further questions.

Sincerely,

Walter D. Cruickshank
Deputy Director and Chief Financial Officer

Enclosure

TAKE PRIDE® IN AMERICA

A. General and Application Controls over Financial Management Systems

MMS concurs that there are certain risks and vulnerabilities associated with its financial information systems. The Office of Management and Budget (OMB) through Circular A-130, Appendix III, *Security of Federal Automated Information Resources,* (A)(2)(a) defines "adequate security" as ensuring security commensurate with the risk and magnitude of the harm resulting from the loss, misuse, or unauthorized access to or modification of information. This includes assuring that systems and applications used by the agency operate effectively and provide appropriate confidentiality, integrity, and availability, through the use of cost-effective management, personnel, operational, and technical controls.

In order to have adequate security, the OMB Circular A-130, Appendix III requires agencies to:

1. Plan for security;
2. Ensure that appropriate officials are assigned security responsibility;
3. Review the security controls in their information systems; and
4. Authorize system processing prior to operations and periodically thereafter.

For each major application and general support system, the MMS has:

1. Developed a security plan;
2. Assigned security responsibility to an individual;
3. Conducted annual security reviews using the NIST Special Publication 800-26;
4. Authorized the system for operation using the *Department of the Interior Information Technology Certification and Accreditation (C&A) Guide*. The process includes:
   a. Privacy Impact Assessment;
   b. Asset Valuation;
   c. System Security Plan;
   d. Risk Assessment;
   e. System Testing & Evaluation;
   f. Plan of Actions and Milestones.

Certification is a comprehensive evaluation of the technical and non-technical security features and other safeguards of an IT system and establishes the extent to which a particular design and implementation meets documented security requirements. *Accreditation* is the formal declaration by an approving authority that an IT system is compliant with established security requirements and is approved to operate using a prescribed set of safeguards.

NIST SP 800-37 *Guide for Security Certification and Accreditation of Federal Information System* states, "The successful completion of the security certification and accreditation process provides agency officials with the necessary confidence that the information system has adequate security controls, and that vulnerabilities in the system have been considered in the risk-based decision to authorize processing."

The MMS has completed the formal Certification and Accreditation process, with associated documentation, to provide evidence of a risk-based methodology that complies with the OMB Circular A-130, Department of the Interior, National Institute of Standards and Technology (NIST) Special Publication (SP) guidance and Federal regulations. This process assures adequate IT system security controls are implemented and tested, risks are assessed, and security plans are maintained. Specifically:

1. *Entity-wide Security Program and Planning*

MMS concurs that its security monitoring and reporting process did not include all systems, platforms, or components. MMS has begun a pilot project of a new tool to provide the needed functionality for audit log monitoring. The preliminary plan is to:

- Select a sampling of servers and network devices to monitor as part of the pilot, (e.g., windows servers, Linux servers, UNIX servers via syslog, routers, switches, firewalls) followed by scheduling an afternoon or morning (4 to 5 hours) to:
  - provide overview of architecture and planned pilot deployment;
  - install and configure monitoring tool; and
  - provide training on use and administration.
- Run the product and evaluate to see if it meets requirements. As experience is gained with the product, we will consider adding firewall and IDS logs as well as any other devices.

MMS also agrees that it has not formally finalized its policy for physical security over the MMS facility in Herndon, VA. The bureau is currently migrating to the Personnel Identification Verification system in compliance with Homeland Security Presidential Directive - 12. Because of the substantial change in processes required by the directive, MMS is in the process of creating an interim policy document that addresses physical security credentials under this new directive.

While MMS agrees that it has not formally finalized its physical security policy, it should be noted that MMS's physical access and environmental monitoring systems currently in place meet or exceed Department of Interior, Department of Justice and OMB standards. Our security policies are being applied consistently and our resources and personnel are protected from unauthorized access.

2. *Access Controls*

MMS concurs that its access control policies and procedures should be fortified. MMS will:

- Implement procedures to ensure all certifiers and time keepers initiate the appropriate forms for system access, and that the forms are maintained as needed.
- Update the current MMSNet access form to ensure all systems are appropriately mentioned on the form.
- Review system access list to ensure forms for all users are on hand.
- Revoke access to MMSNet and application systems in a timely manner for MMS employees who have been terminated.
- Update its exit clearance process to ensure proper training and that all system security managers are notified when a system user terminates employment.

- Implement procedures to review system access listings and revoke access as appropriate.
- Develop a strategy for monitoring security profile changes.
- Develop and implement a policy and procedures to monitor security violations in BIS, PD, ABACIS and Citrix applications on MMSNet; as well as the inactivity of accounts within MMSNet, QuickTime, and ABACIS.

3. *System Software Controls*

MMS concurs with this finding and will:

- Assess the overall risk associated with each condition. If the risk is deemed unacceptable or high risk, MMS will develop and implement a plan for corrective action.
- Review its current systems and develop strategy for monitoring security profile changes.

4. *Software Development and Change Controls*

MMS agrees that it has not fully developed, documented or implemented a change management process for the maintenance of all of its systems. MMS will assess the current change environment and implement procedures as appropriate.

MMS also agrees that programmers have access to the source code, test, and production libraries for the purpose of moving changes through each step of the process from coding to production. However, those involved in testing do not have access to source code, and those involved in production do not have access to source code or testing.

As stated, MMS does not use Library Management Software to manage changes to the ABACIS application. MMS is scheduled to migrate to the FBMS application in the near future. As a result we feel that it would not be cost beneficial to purchase Library Management Software at this time. To mitigate the risk associated with not using this software we have limited those with change privileges to two individuals. We have also implemented a third level of password for the two individuals involved in making changes to allow the production of a report that shows all changes made by individual. This report of changes is being reviewed monthly by the change management group as described in the configuration management plan.

5. *Service Continuity*

MMS concurs with this finding and will:

- Finalize emergency processing priorities for the VA IT Resource Center/Computer Room.
- Conduct and refresh emergency response training annually.
- Assess the value of adding a second air conditioning unit in the VA IT Resource Center/Computer Room against the risk associated with continuing to operate with only unit.

- Ensure maintenance agreements are implemented for all computer room equipment and application hardware.
- Complete the process of removing the overhead plumbing lines from above the VA IT Resource Center/Computer Room. This process is scheduled to be completed by November 30, 2005.
- Finalize the documentation of backup process to include off-site backup and testing.
- Finalize procedures to ensure the MMSNet and FPPS are adequately tested. It should be noted that MMS is not the system owner of FPPS, and therefore cannot schedule or perform testing as recommended. MMS will observe the next FPPS testing but is not allowed to participate in the testing.

B. Controls over Accounts and Interest Receivable

1. *Royalty Receivables*

MMS concurs that it needs to continue to improve controls over accounts receivable related to royalties. MMS has made significant progress over the last year in strengthening the control environment related to receivables and, as such, has reduced aged receivables by approximately $80 million. In addition to this significant accomplishment, a strengthened write-off policy was implemented in June, 2005, and a project was undertaken and resources dedicated to resolving and reducing aged unmatched payments. MMS will continue to dedicate resources to analyze and resolve open account balances.

2. *Debt Referral*

MMS concurs that these items had not been coded as hold items within the accounting system and had not been referred to Treasury. Despite the system status however, had MMS accomplished the proper research, the items would have been placed on hold and therefore not have been required to be referred to Treasury until certain follow-up steps had been accomplished.

On June 2, 2005, the Associate Director for MRM signed a memorandum which changed a long standing policy of MMS involving the debt collection status of royalty documents. Until this memorandum was signed, royalty documents, because of their nature of self reporting with allowance for changes and adjustments, were not pursued under the Debt Collection Improvement Act. However, MMS felt that resolving open and delinquent royalty balances was a high priority and reevaluated this treatment. As a result MMS determined that despite their nature, delinquent self reported royalty items would be referred to Treasury. To ensure accurate referrals, and because of the volume and considerable workload associated with investigating and placing items on hold, MMS made the decision to treat all royalty items as hold items until the proper research could be done. As a result MMS is currently treating all royalty document receivables as hold items regardless of the status indicated within the accounting system.

While MMS agrees that these items were neither referred to Treasury nor placed on hold status within the system, MMS believes that it has sufficient controls to ensure that eligible delinquent debt is referred to Treasury. As noted above, in an effort to ensure that all available channels for collection are pursued, MMS recently made the determination that royalty items are eligible for the debt referral process despite their nature. Accordingly, MMS is developing a process for the timely execution of the required steps to make a debt eligible for referral to Treasury. MMS is currently developing steps to identify royalty documents that will be pursued in accordance with the Debt Collection Improvement Act. The procedures will ensure that:

- Non payment notices are sent
- Telephonic contact is made with the customer
- Demand to sureties are made
- Lessee notices are issued
- Referrals to Justice for litigation or Treasury for collection are made

MMS would also like to note, that despite the status of royalty document items, MMS has developed, and has been applying for years, procedures and controls over other types of debt such as invoices.

C. Debt Collection Improvement Act of 1996

As noted above, MMS concurs and will continue to fortify its controls around royalty reporting with a target completion date of March 31, 2006 to ensure that delinquent royalties receivable are referred to the U.S. Department of Treasury. The procedures will include research into delinquent items and the application of procedures to execute the requirements of the Debt Collection Act.

Principal Financial Statements

Launch of Remotely Operated Vehicle

Department of the Interior
Minerals Management Service
Consolidated Balance Sheet
As of September 30, 2005 and 2004
(dollars in thousands)

	2005	2004
ASSETS		
Intragovernmental Assets:		
Administrative Fund Balance	$ 1,444,636	$ 1,501,562
Custodial Fund Balance	1	1
Restricted Fund Balance	-	2
Fund Balance with Treasury (Note 2)	1,444,637	1,501,565
Restricted Treasury Securities	1,030,926	1,001,652
Custodial Treasury Securities	57,320	27,767
Investments, Net (Note 3)	1,088,246	1,029,419
Custodial Accounts Receivable	400,068	289,150
Administrative Accounts Receivable	4,721	5,840
Accounts and Interest Receivable (Note 4)	404,789	294,990
Other:		
Advances and Prepayments	194	1,283
Total Intragovernmental Assets	2,937,866	2,827,257
Custodial Accounts and Interest Receivable	1,416,540	734,781
Administrative Accounts Receivable	1,009,761	413,255
Accounts and Interest Receivable, Net (Note 4)	2,426,301	1,148,036
General Property, Plant and Equipment, Net (Note 5)	28,543	32,058
Other:		
Advances and Prepayments	2	3
TOTAL ASSETS (Note 6)	$ 5,392,712	$ 4,007,354

Department of the Interior
Minerals Management Service
Consolidated Balance Sheet
As of September 30, 2005 and 2004
(dollars in thousands)

	2005	2004
LIABILITIES		
Intragovernmental Liabilities:		
Accounts Payable	$ 3,464	$ 4,865
Other:		
Custodial Liability	1,799,017	999,250
Advances and Deferred Revenue	1,079,418	1,137,546
Accrued Employee Benefits	3,781	2,866
Total Intragovernmental Liabilities	2,885,680	2,144,527
Accounts Payable	249,353	245,192
Federal Employee Benefits - FECA Actuarial Liability (Note 7)	9,837	8,711
Other:		
State Liabilities	1,009,419	412,881
Contingent Liabilities (Note 8)	550,690	550,000
Advances, Deferred Revenue, and Deposit Funds	52,504	35,387
Custodial Liability	23,238	24,681
Accrued Payroll and Benefits	17,966	16,298
Capital Lease Liability (Note 9)	51	74
TOTAL LIABILITIES (Note 10)	4,798,738	3,437,751
Commitments and Contingencies (Note 8 and 9)		
Net Position		
Unexpended Appropriations	8,573	7,450
Cumulative Results of Operations:		
Administrative Cumulative Results of Operations	(445,525)	(439,501)
EIRF Cumulative Results of Operations	1,030,926	1,001,654
Total Cumulative Results of Operations	585,401	562,153
Total Net Position	593,974	569,603
TOTAL LIABILITIES AND NET POSITION	$ 5,392,712	$ 4,007,354

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, 2005 and 2004
(dollars in thousands)

	2005	2004
Resource Use Energy		
Manage and Provide Incentives for Access and Development		
Costs	$ 80,566	$ 71,184
Less: Earned Revenue	30,114	27,929
Net Cost	50,452	43,255
Enhance Responsible Use Management Practices		
Costs	69,117	71,162
Less: Earned Revenue	33,880	36,591
Net Cost	35,237	34,571
Effective Lease and Permit Management		
Costs	2,373,898	1,474,791
Less: Earned Revenue	58,278	46,955
Net Cost	2,315,620	1,427,836
Improve Information Base, Resource Management and Technical Assistance		
Costs	4,711	5,279
Less: Earned Revenue	2,259	2,131
Net Cost	2,452	3,148
Total Resource Use Energy		
Costs	2,528,292	1,622,416
Less: Earned Revenue	124,531	113,606
Net Cost	2,403,761	1,508,810
Resource Use Non-Energy		
Costs	3,872	2,225
Less: Earned Revenue	2,127	2,063
Net Cost	1,745	162
Serving Communities		
Indian Trust Fulfillment		
Costs	31,163	31,314
Less: Earned Revenue	9,700	9,632
Net Cost	21,463	21,682
Reimbursable Activity and Other		
Interior Franchise Fund		
Costs	1,515,103	1,332,607
Less: Earned Revenue	1,527,354	1,350,756
Net Cost	(12,251)	(18,149)
Other		
Costs	5,301	3,677
Less: Earned Revenue	5,611	3,996
Net Cost	(310)	(319)
Total Reimbursable Activity and Other		
Costs	1,520,404	1,336,284
Less: Earned Revenue	1,532,965	1,354,752
Net Cost	(12,561)	(18,468)
Total		
Costs	4,083,731	2,992,239
Less: Earned Revenue (Note 12)	1,669,323	1,480,053
Net Cost of Operations (Note 11)	$ 2,414,408	$ 1,512,186

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, 2005 and 2004
(dollars in thousands)

	2005	2004
UNEXPENDED APPROPRIATIONS		
Beginning Balances	**$ 7,450**	$ 6,969
Budgetary Financing Sources		
Appropriations Received, General Funds	**169,175**	165,316
Appropriations Transferred In/Out	**3,343**	-
Appropriations-Used	**(168,927)**	(162,538)
Other Adjustments	**(2,468)**	(2,297)
Net Change	**1,123**	481
Ending Balance - Unexpended Appropriations	**$ 8,573**	$ 7,450
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	**$ 562,153**	$ 532,485
Budgetary Financing Sources		
Appropriations-Used	**168,927**	162,538
Other Budgetary Financing Sources - MRM Exchange Revenue (Note 13)	**2,229,171**	1,346,761
Transfers In/Out without Reimbursement	**(3,994)**	(3,983)
Non-Exchange Revenue	**29,273**	24,132
Other Financing Sources		
Imputed Financing from Costs Absorbed by Others	**15,117**	12,975
Transfers In/Out without Reimbursement	**(838)**	(569)
Total Financing Sources	**2,437,656**	1,541,854
Net Cost of Operations	**(2,414,408)**	(1,512,186)
Net Change	**23,248**	29,668
Ending Balance - Cumulative Results of Operations	**$ 585,401**	$ 562,153

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, 2005 and 2004
(dollars in thousands)

	2005	2004
Budgetary Resources:		
Budget Authority:		
Appropriations Received	**$ 1,808,910**	$ 1,340,716
Net Transfers, Current Year Authority	**3,344**	-
Unobligated Balance:		
Beginning of Fiscal Year	**748,532**	731,785
Spending Authority From Offsetting Collections:		
Earned		
Collected	**1,715,892**	1,525,212
Receivable From Federal Sources	**(1,474)**	(16,747)
Change in Unfilled Customer Orders		
Advance Received	**(64,641)**	271,914
Without Advance From Federal Sources	**(10,365)**	(65,953)
Subtotal: Spending Authority From Offsetting Collections	**1,639,412**	1,714,426
Recoveries of Prior Year Obligations	**6,195**	6,225
Temporarily Not Available Pursuant to Public Law	**(99)**	(88)
Permanently Not Available	**(2,467)**	(2,296)
Total Budgetary Resources	**$ 4,203,827**	$ 3,790,768
Status of Budgetary Resources:		
Obligations Incurred:		
Direct (Category B)	**$ 1,810,450**	$ 1,340,054
Reimbursable (Category B)	**1,588,204**	1,702,182
Total Obligations Incurred (Note 14)	**3,398,654**	3,042,236
Unobligated Balance:		
Apportioned	**803,715**	747,763
Unobligated Balance not Available	**1,458**	769
Total Status of Budgetary Resources	**$ 4,203,827**	$ 3,790,768
Relationship of Obligations to Outlays:		
Obligations Incurred	**$ 3,398,654**	$ 3,042,236
Obligated Balance, Net, Beginning of Fiscal Year	**753,004**	527,364
Obligated Balance, Net, End of Fiscal Year:		
Accounts Receivable	**5,433**	6,907
Unfilled Customer Orders From Federal Sources	**168,277**	178,641
Undelivered Orders	**(552,805)**	(681,852)
Accounts Payable	**(260,367)**	(256,700)
Total Obligated Balance, Net, End of Fiscal Year	**(639,462)**	(753,004)
Less: Spending Authority Adjustments	**5,644**	76,475
Outlays:		
Disbursements	**3,517,840**	2,893,071
Collections	**(1,651,249)**	(1,797,126)
Net Outlays Before Offsetting Receipts	**1,866,591**	1,095,945
Less: Offsetting Receipts	**(2,070,117)**	(1,427,168)
Net Outlays (Receipts)	**$ (203,526)**	$ (331,223)

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, 2005 and 2004
(dollars in thousands)

		2005		2004
Resources Used to Finance Activities:				
Budgetary Resources Obligated:				
Obligations Incurred	**$ 3,398,654**		$ 3,042,236	
Less: Spending Authority From Offsetting Collections/Recoveries	**(1,645,607)**		(1,720,651)	
Obligations Net of Offsetting Collections and Adjustments	**1,753,047**		1,321,585	
Less: Offsetting Receipts	**(2,070,117)**		(1,427,168)	
Net Obligations	**(317,070)**		(105,583)	
Other Resources:				
Transfers In/Out Without Reimbursement	**(838)**		(569)	
Imputed Financing From Costs Absorbed by Others	**15,117**		12,975	
Net Other Resources Used to Finance Activities	**14,279**		12,406	
Total Resources Used to Finance Activities		**(302,791)**		(93,177)
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	**130,103**		(198,348)	
Increase (Decrease) Unfilled Customer Orders	**(75,006)**		205,962	
Resources That Fund Expenses Recognized in Prior Periods	**32**		(954)	
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations:				
Offsetting Receipts Not Part of the Net Cost of Operations	**2,070,117**		1,427,168	
Resources That Finance the Acquisition of Assets	**(1,376)**		(815)	
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operations	**(11,000)**		(11,000)	
Total Resources Used to Finance Items Not Part of the Net Cost of Operations		**2,112,870**		1,422,013
Total Resources Used to Finance the Net Cost of Operations		**1,810,079**		1,328,836
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 19)	**616**		1,216	
Other (Note 19)	**599,036**		178,585	
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	**599,652**		179,801	
Components Not Requiring or Generating Resources:				
Depreciation and Amortization	**4,892**		5,119	
Other	**(215)**		(1,570)	
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	**4,677**		3,549	
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period		**604,329**		183,350
Net Cost of Operations		**$ 2,414,408**		$ 1,512,186

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, 2005 and 2004

(dollars in thousands)

	2005	2004
Revenues on Behalf of the Federal Government		
Mineral Lease Revenue		
Rents and Royalties	**$ 8,968,062**	$ 7,114,290
Onshore Lease Sales	**1,658,786**	383,945
Offshore Lease Sales	**560,622**	560,225
Strategic Petroleum Reserve (Note 20)	**1,194,618**	1,191,284
Total Revenue	**$ 12,382,088**	$ 9,249,744
Disposition of Revenue		
Distribution to Department of the Interior		
Minerals Management Service (Note 21)	**$ 1,762,091**	$ 1,300,525
Bureau of Reclamation	**1,287,972**	924,486
National Park Service Conservation Funds	**1,048,870**	1,049,000
Bureau of Land Management	**81,408**	16,216
Fish and Wildlife Service	**1,036**	737
Distribution to Other Federal Agencies		
Department of the Treasury	**5,502,192**	4,375,633
Department of Energy (Note 20)	**1,194,618**	1,191,284
Department of Agriculture	**50,860**	25,232
Department of the Commerce	**1**	-
Distribution to Indian Tribes and Agencies	**114,025**	93,892
Distribution to States and Others	**72,323**	75,776
Change in Untransferred Revenue	**1,266,692**	196,963
Total Disposition of Revenue	**$ 12,382,088**	$ 9,249,744

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


DOCKWISE
BLUE MARLIN

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 and the Government Management Reform Act of 1994.

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). 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 the Minerals Management Service, including, Royalty and Offshore Minerals 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.

The Minerals Revenue Management (MRM) Program, within 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 Interior Franchise Fund (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 and represents 29 percent of assets and 33 percent of liabilities on the FY 2005 consolidated balance sheet, 89 percent of MMS total revenues on the FY 2005 consolidated statement of net cost, and 53 percent of the total budgetary resources on the FY 2005 combined statement of budgetary resources.

The Secretary of Interior issued an order dated September 29, 2005 indicating management's decision to transfer the Interior Franchise Fund, including the appropriate personnel, funds, records, and property, from the Minerals Management Service to Departmental Offices on October 2, 2005.

Statement of Federal Financial Accounting Concept No. 2, *Entity and Display*, indicates that any organization, program, or budget account included in an entity's section of the President's Budget should be considered part of the organization with which it appears (i.e., conclusive criterion). In addition, OMB Circular A-136, *Financial Reporting Requirements*, indicates that OMB approval shall be obtained for exemptions to the conclusive criterion.

Interior Franchise Fund appears as part of the Minerals Management Service's section of the President's Budget and does not appear as part of Departmental Office's section of the President's Budget. As a result, management is working with OMB to obtain approval for the transfer of Interior Franchise Fund from Minerals Management Service to Departmental Offices; however, Minerals Management Service has not received approval from OMB. Until the Minerals Management Service receives approval from OMB, the Minerals Management Service will continue to report the Interior Franchise Fund as part of its reporting entity.

Section 632 of Title VI within the General Provisions of the President's 2006 budget, extends the Franchise Fund Pilot Program authorizing legislation to October 1, 2006. The IFF sunset date creates an uncertainty about IFF's ability to continue as a going concern because the operation of the IFF is dependent on the extension of its authorizing legislation.

Management's plan with respect to the uncertainty discussed above is to work with Departmental Offices to obtain final approval for the transfer and to continue its non-IFF funds and programs. Should the transfer be unsuccessful MMS will continue to operate the IFF and will seek additional wording in the FY 2007 appropriation language that establishes franchising as a permanent program or provides franchise-like authority permanently. If the IFF remains with MMS and the plan to obtain extended or permanent authorization are unsuccessful, MMS will no longer offer services under IFF and instead offer the same services under the authority of the Economy Act and adjust its pricing conventions to eliminate retained earnings.

In accordance with OMB Circular A-136, Financial Reporting Requirements, comparative statements will be 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 Circular A-136, Financial Reporting Requirements, 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 Circular A-136, 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's 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 and Interest 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. General Property, Plant, and Equipment, Net

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.

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 for future benefit payments as a result of past events. 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.

Deferred revenue consists of receipts retained from royalty collections for the Strategic Petroleum Reserve (SPR). MMS is also authorized to retain collections for the transportation costs of the royalty oil taken in kind from Federal leases in the Gulf of Mexico, which is transferred to the Department of Energy. SPR receipts are recorded as deferred revenue when collected and the revenue is recognized when costs are incurred for transportation costs.

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 ten 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 15 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 of up to four percent in accordance with the 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.

Provisions in the FY 2005 Department of the Interior Appropriation's Bill enable MMS to recover Royalty-in-Kind (RIK) sales revenue previously transferred to Treasury to offset the expenses associated with transportation, processing and administrative costs for the RIK sales. Similar legislative provisions enable MMS to recover RIK sales revenue previously transferred to Treasury to offset the necessary expenses incurred to deliver oil of sufficient quality and quantity to the Department of Energy for deposit into the Strategic Petroleum Reserve.

Appropriations: Appropriations are recognized as financing sources on the Statement of Changes in Net Position 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. In addition, appropriations are recorded as budgetary authority on the Statement of Budgetary Resources when realized.

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. During FY 2005, MMS prospectively implemented the Federal Accounting Standards Advisory Board's Interpretation Number 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS Number 4*. As a result, MMS recognized $1.7 million of imputed financing sources and costs in FY 2005. 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 operations by other federal agencies.

Q. Net Position

Net position consists of unexpended appropriations and cumulative results of operations. 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 not available until appropriated by Congress. As of September 30, 2005 and 2004, 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 2004 financial statements and footnotes to conform with fiscal year 2005 presentation requirements.

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

A. Financing Sources and Revenues

MMS collects and accrues for lease sales, 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. MMS recognizes lease sales as bids are accepted and executed, rents when earned, and royalties and other receipts when MMS has legal claim.

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 Effective Lease and Permit Management program on the FY 2005 and FY 2004 Statements of Net Cost, respectively, 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 determines the value of the RIK commodity using the fair market value on the date of the sale. MMS reflects royalty-in-kind as mineral lease revenue and as distributions to Federal agencies on the Statement of Custodial Activity.

MMS 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 2005 and 2004, MMS transferred approximately 25.6 and 38.4 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 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 2005 and 2004, MMS deposited to the EIRF interest earned from investments of the EIRF principal. Congress has permanently appropriated 20 percent of the prior fiscal year interest earned by the EIRF to the Department of Commerce. The remaining 80 percent of interest earned remains in the fund and is recorded as other non-exchange revenue on the Statement of Changes in Net Position. The remaining interest earned 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 to other Federal entities 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.

Based on legislation, 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

MMS 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 "Custodial Fund Balance with Treasury" as shown on the Consolidated Balance Sheet includes deposit and clearing account balances that are not available for obligation.

At the end of each fiscal year, MMS distributes the undisbursed custodial clearing account fund balance to the General Fund of the Treasury and reports the portion due to non-Treasury entities as a custodial accounts receivable. At the beginning of the following year, the balance is returned from Treasury and is available for distribution to the beneficiaries.

D. Accounts and Interest Receivable

The custodial and administrative receivables represent amounts due for royalty revenue, deferred bonuses, accumulated interest, audit bills, and royalty in kind.

Oil and gas companies provide MMS sureties to secure the majority of receivables under appeal. The current surety value is $154 million and $303 million as of September 30, 2005 and 2004, respectively.

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

Receivables due from the public are reported net of allowances for uncollectible amounts. 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

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 for T-Bills, short term T-Notes and long-term T-Notes are amortized using effective interest method. Interest on investments is accrued as it is earned and is recorded as other non-exchange revenue on the Statement of Changes in Net Position.

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 is available for investment under the DOI and Related Agencies Appropriations Act, 1998. Congress has permanently appropriated 20 percent of the prior fiscal year interest earned by the EIRF to the Department of Commerce. The remaining 80 percent 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 high bidders for all OCS lease sales. Should any of the high bids later be rejected, the 1/5 bid and actual interest earned are returned to the bidder. Should the bidder forfeit their bid, the 1/5 bonus and accrued interest reverts to Treasury. The interest earned on accepted bids reverts to the Treasury when the bids are accepted.

F. Liabilities

MMS liabilities include custodial liabilities and deposit 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.

Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources. MMS does not record a payable for potential overpayments by payors as MMS is not obligated, according to the Federal Oil and Gas Royalty Management Act of 1982 (PL 97-451, 96 Stat. 2447, 30 USC 1701), to repay such amounts until requested by the payor or until MMS completes a compliance audit and determines the amount that is refundable.

G. State 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 as "State Liabilities".

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 funds for oil spill research and development. The revolving funds represent collections from Interior Franchise Fund customers. The special fund represents EIRF. Refer to note 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 that 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.

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

	FY 2005	FY 2004
General Funds	$104,850	$100,446
Special Funds	-	2
Revolving Funds	1,332,913	1,394,224
Trust Funds	6,872	6,866
Other Fund Types	2	27
Total Fund Balance with Treasury by Fund Type	**$1,444,637**	**$1,501,565**

The table below displays the status of Fund Balance with Treasury amounts obligated and unobligated as presented in the Statement of Budgetary Resources.

Status of Fund Balance with Treasury
As of September 30
(dollars in thousands)

	FY 2005	FY 2004
Unobligated		
Available	$803,715	$747,763
Unavailable	1,458	769
Obligated Not Yet Disbursed	639,462	753,004
Subtotal	**1,444,635**	**1,501,536**
FBWT not Covered by Budgetary Resources:		
Deposits Fund, Clearing, and Suspense Accounts	2	29
Total Status of Fund Balance with Treasury	**$1,444,637**	**$1,501,565**

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 1.2E, and the custodial investments are discussed in Footnote 1.2E.

As of September 30, 2005
(dollars in thousands)

Description	Cost	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Non-Marketable market-based Treasury Securities				
Restricted	$1,032,450	$(6,803)	$1,025,647	$1,014,909
Custodial	57,214	106	57,320	57,261
Total U.S. Treasury Securities	**1,089,664**	**(6,697)**	**1,082,967**	**1,072,170**
Restricted Accrued Interest	5,279	-	5,279	-
Total Treasury Securities	**$1,094,943**	**($6,697)**	**$1,088,246**	**$1,072,170**

As of September 30, 2004
(dollars in thousands)

Description	Cost	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Non-Marketable market-based Treasury Securities				
Restricted	$1,003,202	($6,911)	$996,291	$1,007,471
Custodial	27,759	8	27,767	27,769
Total U.S. Treasury Securities	**1,030,961**	**(6,903)**	**1,024,058**	**1,035,240**
Restricted Accrued Interest	5,361	-	5,361	-
Total Treasury Securities	**$1,036,322**	**($6,903)**	**$1,029,419**	**$1,035,240**

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. MMS has custodial accounts receivable from intragovernmental agencies totaling $400 million and $289 million, of which, $344 and $216 million is due from Department of the Treasury and $56 and $73 million is due from Bureau of Land Management in FY 2005 and FY 2004, respectively. Interest receivables are included as part of the custodial receivables in the amount of $65 million and $175 million as of September 30, 2005 and 2004, 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)

	FY 2005	FY 2004
Accounts Receivable from Federal Agencies		
Billed - Current	$56,124	$18,448
Unbilled Accounts Receivable	348,665	276,542
Total Accounts Receivable - Federal	**404,789**	**294,990**
Allowance for Doubtful Accounts	-	-
Total Accounts Receivable - Federal Net of Allowance	**404,789**	**294,990**
Change in Allowance for Bad Debts - Federal		
Allowance for Doubtful Accounts, Beginning	-	$1,577
Deletions	-	(1,577)
Allowance for Bad Debts - Federal	**$-**	**$-**

	FY 2005	FY 2004
Accounts and Interest Receivable from the Public		
Current	$60,330	$57,522
1 - 180 Days Past Due	113,008	8,930
181 - 365 Days Past Due	9,217	31,066
1 to 2 Years Past Due	21,427	48,460
Over 2 Years Past Due	76,688	222,699
Total Billed Accounts and Interest Receivable - Public	**$280,670**	**$368,677**
Unbilled Accounts Receivable	2,299,814	1,057,392
Total Accounts and Interest Receivable - Public	**$2,580,484**	**$1,426,069**
Allowance for Doubtful Accounts	(154,183)	(278,033)
Total Accounts and Interest Receivable - Public, Net of Allowance	**$2,426,301**	**$1,148,036**
Change in Allowance for Bad Debts - Public		
Allowance for Doubtful Accounts, Beginning	$278,033	$293,467
Deletions	(123,850)	(15,434)
Allowance for Bad Debts - Public	**$154,183**	**$278,033**

Note 5. General Property, Plant and Equipment, Net

MMS property and equipment categories, with corresponding accumulated depreciation, are shown in the table below. Depreciation expense amounted to approximately $4.9 million and $5.1 million as of September 30, 2005 and 2004, respectively.

General Property, Plant and Equipment, Net
As of September 30, 2005
(dollars in thousands)

Description	Acquisition Cost	Accumulated Depreciation	Net Book Value
Equipment and Vehicles	$15,405	($12,004)	$3,401
Assets under Capital Lease	179	(114)	65
Internal Use Software, In Use	37,149	(12,072)	25,077
Total General Property, Plant and Equipment	**$52,733**	**($24,190)**	**$28,543**

General Property, Plant and Equipment, Net
As of September 30, 2004
(dollars in thousands)

Description	Acquisition Cost	Accumulated Depreciation	Net Book Value
Equipment and Vehicles	$15,874	($12,021)	$3,853
Assets Under Capital Lease	179	(84)	95
Internal Use Software, In Use	36,520	(8,410)	28,110
Total General Property, Plant and Equipment	**$52,573**	**($20,515)**	**$32,058**

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. 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
As of September 30, 2005
(dollars in thousands)

Description	Entity Unrestricted	Entity Restricted	Total Entity	Non-Entity	FY 2005
Intragovernmental Assets:					
Fund Balance with Treasury	$1,444,636	$-	$1,444,636	$1	$1,444,637
Investments, Net	-	1,030,926	1,030,926	57,320	1,088,246
Accounts and Interest Receivable	4,721	-	4,721	400,068	404,789
Other:					
Advances and Prepayments	194	-	194	-	194
Total Intragovermental Assets	**1,449,551**	**1,030,926**	**2,480,477**	**457,389**	**2,937,866**
Accounts and Interest Receivable, Net	343	-	343	2,425,958	2,426,301
General Property, Plant and Equipment, Net	28,543	-	28,543	-	28,543
Other:					
Advances and Prepayments	2	-	2	-	2
Total Assets	**$1,478,439**	**$1,030,926**	**$2,509,365**	**$2,883,347**	**$5,392,712**

Assets Analysis
As of September 30, 2004
(dollars in thousands)

Description	Entity Unrestricted	Entity Restricted	Total Entity	Non-Entity	FY 2004
Intragovernmental Assets:					
Fund Balance with Treasury	$1,501,562	$2	$1,501,564	$1	$1,501,565
Investments, Net	-	1,001,652	1,001,652	27,767	1,029,419
Accounts and Interest Receivable	5,840	-	5,840	289,150	294,990
Other:					
Advances and Prepayments	1,283	-	1,283	-	1,283
Total Intragovermental Assets	**1,508,685**	**1,001,654**	**2,510,339**	**316,918**	**2,827,257**
Accounts and Interest Receivable, Net	374	-	374	1,147,662	1,148,036
General Property, Plant and Equipment, Net	32,058	-	32,058	-	32,058
Other:					
Advances and Prepayments	3	-	3	-	3
Total Assets	**$1,541,120**	**$1,001,654**	**$2,542,774**	**$1,464,580**	**$4,007,354**

Note 7. Federal Employee Benefits – FECA Actuarial Liability

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 $9.8 million and $8.7 million as of September 30, 2005 and 2004, respectively. This liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Projected annual benefit payments are discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds. The resulting liability is then distributed by DOL to each benefiting agency.

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. The cases primarily relate to oil and gas leases and employee claims. MMS accrued $551 and $550 million as of September 30, 2005 and 2004, respectively, for claims deemed probable of loss and where the amount of potential liability can be estimated. 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. The potential liability claims deemed to be probable and reasonably possible of loss are estimated in the chart below:

Estimated Range of Loss
As of September 30, 2005
(dollars in thousands)

	Range of Loss	
	Lower End of Range	**Upper End of Range**
Contingent Liabilities:		
Probable	$550,690	$1,200,690
Reasonably Possible	50	100
Total Contingent Liabilities Costs	**$550,740**	**$1,200,790**

Estimated Range of Loss
As of September 30, 2004
(dollars in thousands)

	Range of Loss	
	Lower End of Range	**Upper End of Range**
Contingent Liabilities:		
Probable	$550,000	$1,200,000
Total Contingent Liabilities Costs	**$550,000**	**$1,200,000**

Note 9. Leases

Capital Leases:

MMS has six capital leases 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 $179 thousand and $65 thousand as of September 30, 2005, and $179 thousand and $95 thousand as of September 30, 2004, respectively. The table below shows the future payments expected for these lease agreements.

Future Capital Lease Payments
As of September 30, 2005
(dollars in thousands)

Capital Leases:	
Fiscal Year	**Copiers**
2006	$26
2007	22
2008	19
2009	-
2010	-
Therafter	-
Total Future Capital Lease Payments	**67**
Less: Imputed Interest	(16)
Net Capital Lease Liability	**$51**

Note 9. Leases (Continued)

Operating Leases:

MMS has several General Services Administration (GSA) operating lease agreements for office space and vehicles. The terms of the space 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. The GSA lease vehicle agreements are typically on a year-by-year basis or are cancelable at any time. 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.

For real and personal property, future operating lease payments are calculated based on the terms of the lease or if the lease is silent, an annual inflationary factor of 1.5 percent for fiscal year 2006 and 2.4 percent for years 2007 and beyond. The inflationary factors are applied against the actual 2005 rental expense. For operating leases that have an indefinite period of performance, future lease payments are only calculated for six years.

MMS also has some equipment operating leases for copiers that are not disclosed in the schedule below as the amounts are insignificant. The Federal Real Property category consists of the office space leases, and the Federal Personal Property consists of the vehicles leases.

Future Operating Lease Payments
As of September 30, 2005
(dollars in thousands)

Operating Leases:			
Fiscal Year	Federal Real Property	Federal Personal Property	Total
2006	$12,869	$39	$12,908
2007	12,874	40	12,914
2008	13,183	41	13,224
2009	13,499	42	13,541
2010	13,823	43	13,866
Thereafter	27,081	-	27,081
Total Future Operating Lease Payments	**$93,329**	**$205**	**$93,534**

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. The Custodial Liability and Liabilities to States, which are current liabilities, not covered by budgetary resources, are further discussed in Footnote 1.2F.

Liabilities
As of September 30, 2005
(dollars in thousands)

	Covered by Budgetary Resources	Not Covered by Budgetary Resources		
	Current	Current	Non-Current	FY 2005
Intragovernmental Liabilities:				
Accounts Payable	$3,464	$-	$-	$3,464
Other:				
Custodial Liability	-	1,799,017	-	1,799,017
Advances and Deferred Revenue	1,079,418	-	-	1,079,418
Accrued Employee Benefits	1,104	845	1,832	3,781
Total Other Liabilities	1,080,522	1,799,862	1,832	2,882,216
Total Intragovernmental Liabilities	**1,083,986**	**1,799,862**	**1,832**	**2,885,680**
Public Liabilities:				
Accounts Payable	249,353	-	-	249,353
Federal Employee Benefits - FECA Actuarial Liability	-	-	9,837	9,837
Other:				
State Liabilities	-	1,009,419	-	1,009,419
Contingent Liabilities	-	690	550,000	550,690
Advances, Deferred Revenue, and Deposit Funds	830	51,674	-	52,504
Custodial Liability	-	23,238	-	23,238
Accrued Payroll and Benefits	5,737	-	12,229	17,966
Capital Lease Liability	-	51	-	51
Total Other Liabilities	6,567	1,085,072	562,229	1,653,868
Total Public Liabilities	**255,920**	**1,085,072**	**572,066**	**1,913,058**
Total Liabilities	**$1,339,906**	**$2,884,934**	**$573,898**	**$4,798,738**

Note 10. Liabilities (Continued)

Liabilities
As of September 30, 2004
(dollars in thousands)

	Covered by Budgetary Resources	Not Covered by Budgetary Resources		
	Current	**Current**	**Non-Current**	**FY 2004**
Intragovernmental Liabilities:				
Accounts Payable	$4,865	$-	$-	$4,865
Other:				
Custodial Liability	-	999,250	-	999,250
Advances and Deferred Revenue	1,137,546	-	-	1,137,546
Accrued Employee Benefits	895	584	1,387	2,866
Total Other Liabilities	1,138,441	999,834	1,387	2,139,662
Total intragovernmental Liabilities	**1,143,306**	**999,834**	**1,387**	**2,144,527**
Public Liabilities:				
Accounts Payable	245,192	-	-	245,192
Federal Employee Benefits - FECA Actuarial Liability	-	-	8,711	8,711
Other:				
State Liabilities	-	412,881	-	412,881
Contingent Liabilities	-	-	550,000	550,000
Advances, Deferred Revenue, and Deposit Funds	7,594	27,793	-	35,387
Custodial Liability	-	24,681	-	24,681
Accrued Payroll and Benefits	4.685	-	11,613	16,298
Capital Lease Liability	-	74	-	74
Total Other Liabilities	12,279	465,429	561,613	1,039,321
Total Public Liabilities	**257,471**	**465,429**	**570,324**	**1,293,224**
Total Liabilities	**$1,400,777**	**$1,465,263**	**$571,711**	**$3,437,751**

Note 11. Net Cost by Responsibility Segment

The Government Performance Results Act (GPRA) requires that Federal agencies formulate Strategic Plans, identify major strategic goals, and report performance and costs related to these goals. Under GPRA, Strategic Plans are to be revised and updated every three years. Accordingly, the Department of the Interior (Department) updated the Department-wide Strategic Plan in FY 2004. OMB Circular A-136 Financial Reporting Requirements requires that the presentation of the Statement of Net Cost align directly with the goals and outcomes identified in the Strategic Plan. Accordingly, MMS has presented the earned revenues and gross costs in FY 2005 and FY 2004 by the applicable mission goals and categories in the Department's FY 2004 Strategic Plan as follows.

1. Resource Use
    a. Resource Use Energy
        i. Manage and Provide Incentives for Access and Development
        ii. Enhance Responsible Use Management Practices
        iii. Effective Lease and Permit Management
        iv. Improve Information Base, Resource Management and Technical Assistance
    a. Resource Use Non-Energy
2. Serving Communities
    a. Indian Trust Fulfillment
3. Reimbursable Activity and Other
    a. Interior Franchise Fund
    b. Other

OMB Circular A-136 has changed the disclosure requirements for transactions between Federal entities and with the public. Under the revised guidance, MMS presents costs paid to federal agencies as well as costs paid to the public. This presentation is different from how costs were previously reported. Specifically, in prior years, MMS presented the estimated costs associated with earning revenue from Federal or public sources rather than amounts paid to Federal agencies or to the public. Total costs remain unchanged. Due to the change in the presentation of intra-governmental and public costs, Interior's FY 2004 Consolidated Statement of Net Costs has been reclassified to correspond to the new presentation.

The tables on the following pages present MMS's earned revenues, gross cost and net cost of operations by program and by responsibility segment.

Note 11. Net Cost by Responsibility Segment (Continued)

Schedule of Net Cost by Program and Responsibility Segment
For the year ended September 30, 2005
(dollars in thousands)

	Offshore Minerals Management	Mineral Revenue Management	Interior Franchise Fund	Other	Elimination of Intra Bureau Activity	2005
Resource Use Energy						
Manage and Provide Incentives for Access and Development						
Intragovernmental Costs	$ 13,487	$ -	$ -	$ -	$ -	$ 13,487
Public Costs	67,079	-	-	-	-	67,079
Total Costs	80,566	-	-	-	-	80,566
Total Public Earned Revenue	30,114	-	-	-	-	30,114
Net Costs	50,452	-	-	-	-	50,452
Enhance Responsible Use Management Practices						
Intragovernmental Costs	20,675	220	-	-	-	20,895
Public Costs	34,673	13,549	-	-	-	48,222
Total Costs	55,348	13,769	-	-	-	69,117
Total Public Earned Revenue	20,111	13,769	-	-	-	33,880
Net Costs	35,237	-	-	-	-	35,237
Effective Lease and Permit Management						
Intragovernmental Costs	9,129	27,243	-	-	-	36,372
Public Costs	43,261	2,294,265	-	-	-	2,337,526
Total Costs	52,390	2,321,508	-	-	-	2,373,898
Total Public Earned Revenue	17,163	41,115	-	-	-	58,278
Net Costs	35,227	2,280,393	-	-	-	2,315,620
Improve Information Base, Resource Management and Technical Assistance						
Intragovernmental Costs	456	-	-	-	-	456
Public Costs	4,255	-	-	-	-	4,255
Total Costs	4,711	-	-	-	-	4,711
Total Public Earned Revenue	2,259	-	-	-	-	2,259
Net Costs	2,452	-	-	-	-	2,452
Total Resource Use Energy						
Intragovernmental Costs	43,747	27,463	-	-	-	71,210
Public Costs	149,268	2,307,814	-	-	-	2,457,082
Total Costs	193,015	2,335,277	-	-	-	2,528,292
Total Public Earned Revenue	69,647	54,884	-	-	-	124,531
Net Costs	123,368	2,280,393	-	-	-	2,403,761
Resource Use Non-Energy						
Intragovernmental Costs	324	-	-	-	-	324
Public Costs	3,548	-	-	-	-	3,548
Total Costs	3,872	-	-	-	-	3,872
Total Public Earned Revenue	2,127	-	-	-	-	2,127
Net Costs	1,745	-	-	-	-	1,745
Serving Communities						
Indian Trust Fulfillment						
Intragovernmental Costs	-	9,822	-	-	-	9,822
Public Costs	-	21,341	-	-	-	21,341
Total Costs	-	31,163	-	-	-	31,163
Total Public Earned Revenue	-	9,700	-	-	-	9,700
Net Costs	-	21,463	-	-	-	21,463
Reimbursable Activity and Other						
Interior Franchise Fund						
Intragovernmental Costs	-	-	58,317	-	(45,619)	12,698
Public Costs	-	-	1,502,405	-	-	1,502,405
Total Costs	-	-	1,560,722	-	(45,619)	1,515,103
Total Intragovernmental Earned Revenue	-	-	1,572,973	-	(45,619)	1,527,354
Net Costs	-	-	(12,251)	-	-	(12,251)

Note 11. Net Cost by Responsibility Segment (Continued)

Schedule of Net Cost by Program and Responsibility Segment

For the year ended September 30, 2005
(dollars in thousands)

	Offshore Minerals Management	Mineral Revenue Management	Interior Franchise Fund	Other	Elimination of Intra Bureau Activity	2005
Other						
Intragovernmental Costs	$ -	$ -	$ -	$ 540	$ -	$ 540
Public Costs	-	-	-	4,761	-	4,761
Total Costs	-	-	-	5,301	-	5,301
Intragovernmental Earned Revenue	-	-	-	4,943	-	4,943
Public Earned Revenue	-	-	-	668	-	668
Total Earned Revenue	-	-	-	5,611	-	5,611
Net Costs	-	-	-	(310)	-	(310)
Total Reimbursable Activity and Other						
Intragovernmental Costs	-	-	58,317	540	(45,619)	13,238
Public Costs	-	-	1,502,405	4,761	-	1,507,166
Total Costs	-	-	1,560,722	5,301	(45,619)	1,520,404
Intragovernmental Earned Revenue	-	-	1,572,973	4,943	(45,619)	1,532,297
Public Earned Revenue	-	-	-	668	-	668
Total Earned Revenue	-	-	1,572,973	5,611	(45,619)	1,532,965
Net Costs	-	-	(12,251)	(310)	-	(12,561)
Total						
Intragovernmental Costs	44,071	37,285	58,317	540	(45,619)	94,594
Public Costs	152,816	2,329,155	1,502,405	4,761	-	3,989,137
Total Costs	196,887	2,366,440	1,560,722	5,301	(45,619)	4,083,731
Intragovernmental Earned Revenue	-	-	1,572,973	4,943	(45,619)	1,532,297
Public Earned Revenue	71,774	64,584	-	668	-	137,026
Total Earned Revenue	71,774	64,584	1,572,973	5,611	(45,619)	1,669,323
Net Costs	$ 125,113	$ 2,301,856	$ (12,251)	$ (310)	$ -	$ 2,414,408

Note 11. Net Cost by Responsibility Segment (Continued)

Schedule of Net Cost by Program and Responsibility Segment

For the year ended September 30, 2004
(dollars in thousands)

	Offshore Minerals Management	Mineral Revenue Management	Interior Franchise Fund	Other	Elimination of Intra Bureau Activity	2004
Resource Use Energy						
Manage and Provide Incentives for Access and Development						
Intragovernmental Costs	$ 15,463	$ -	$ -	$ -	$ -	$ 15,463
Public Costs	55,721	-	-	-	-	55,721
Total Costs	71,184	-	-	-	-	71,184
Total Public Earned Revenue	27,929	-	-	-	-	27,929
Net Costs	43,255	-	-	-	-	43,255
Enhance Responsible Use Management Practices						
Intragovernmental Costs	22,413	274	-	-	-	22,687
Public Costs	30,736	17,739	-	-	-	48,475
Total Costs	53,149	18,013	-	-	-	71,162
Total Public Earned Revenue	18,578	18,013	-	-	-	36,591
Net Costs	34,571	-	-	-	-	34,571
Effective Lease and Permit Management						
Intragovernmental Costs	10,315	15,868	-	-	-	26,183
Public Costs	34,404	1,414,204	-	-	-	1,448,608
Total Costs	44,719	1,430,072	-	-	-	1,474,791
Total Public Earned Revenue	15,705	31,250	-	-	-	46,955
Net Costs	29,014	1,398,822	-	-	-	1,427,836
Improve Information Base, Resource Management and Technical Assistance						
Intragovernmental Costs	632	-	-	-	-	632
Public Costs	4,647	-	-	-	-	4,647
Total Costs	5,279	-	-	-	-	5,279
Total Public Earned Revenue	2,131	-	-	-	-	2,131
Net Costs	3,148	-	-	-	-	3,148
Total Resource Use Energy						
Intragovernmental Costs	48,823	16,142	-	-	-	64,965
Public Costs	125,508	1,431,943	-	-	-	1,557,451
Total Costs	174,331	1,448,085	-	-	-	1,622,416
Total Public Earned Revenue	64,343	49,263	-	-	-	113,606
Net Costs	109,988	1,398,822	-	-	-	1,508,810
Resource Use Non-Energy						
Intragovernmental Costs	411	-	-	-	-	411
Public Costs	1,814	-	-	-	-	1,814
Total Costs	2,225	-	-	-	-	2,225
Total Public Earned Revenue	2,063	-	-	-	-	2,063
Net Costs	162	-	-	-	-	162
Serving Communities						
Indian Trust Fulfillment						
Intragovernmental Costs	-	6,165	-	-	-	6,165
Public Costs	-	25,149	-	-	-	25,149
Total Costs	-	31,314	-	-	-	31,314
Total Public Earned Revenue	-	9,632	-	-	-	9,632
Net Costs	-	21,682	-	-	-	21,682
Reimbursable Activity and Other						
Interior Franchise Fund						
Intragovernmental Costs	-	-	40,691	-	(28,860)	11,831
Public Costs	-	-	1,320,776	-	-	1,320,776
Total Costs	-	-	1,361,467	-	(28,860)	1,332,607
Intragovernmental Earned Revenue	-	-	1,379,608	-	(28,860)	1,350,748
Public Earned Revenue	-	-	8	-	-	8
Total Earned Revenue	-	-	1,379,616	-	(28,860)	1,350,756
Net Costs	-	-	(18,149)	-	-	(18,149)

Note 11. Net Cost by Responsibility Segment (Continued)

Schedule of Net Cost by Program and Responsibility Segment
For the year ended September 30, 2004
(dollars in thousands)

	Offshore Minerals Management	Mineral Revenue Management	Interior Franchise Fund	Other	Elimination of Intra Bureau Activity	2004
Other						
Intragovernmental Costs	$ -	$ -	$ -	$ 422	$ -	$ 422
Public Costs	-	-	-	3,255	-	3,255
Total Costs	-	-	-	3,677	-	3,677
Intragovernmental Earned Revenue	-	-	-	3,556	-	3,556
Public Earned Revenue	-	-	-	440	-	440
Total Earned Revenue	-	-	-	3,996	-	3,996
Net Costs	-	-	-	(319)	-	(319)
Total Reimbursable Activity and Other						
Intragovernmental Costs	-	-	40,691	422	(28,860)	12,253
Public Costs	-	-	1,320,776	3,255	-	1,324,031
Total Costs	-	-	1,361,467	3,677	(28,860)	1,336,284
Intragovernmental Earned Revenue	-	-	1,379,608	3,556	(28,860)	1,354,304
Public Earned Revenue	-	-	8	440	-	448
Total Earned Revenue	-	-	1,379,616	3,996	(28,860)	1,354,752
Net Costs	-	-	(18,149)	(319)	-	(18,468)
Total						
Intragovernmental Costs	49,234	22,307	40,691	422	(28,860)	83,794
Public Costs	127,322	1,457,092	1,320,776	3,255	-	2,908,445
Total Costs	176,556	1,479,399	1,361,467	3,677	(28,860)	2,992,239
Intragovernmental Earned Revenue	-	-	1,379,608	3,556	(28,860)	1,354,304
Public Earned Revenue	66,406	58,895	8	440	-	125,749
Total Earned Revenue	66,406	58,895	1,379,616	3,996	(28,860)	1,480,053
Net Costs	$ 110,150	$ 1,420,504	$ (18,149)	$ (319)	$ -	$ 1,512,186

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.

Fiscal Years 2005 and 2004
(dollars in thousands)

Description	FY 2005	FY 2004
Sales of Goods and Services:		
To the Public	$359	$129
To Other Federal Agencies - IFF	1,527,354	1,350,748
To Other Federal Agencies - Other	4,943	3,556
Other Revenues:		
Other Revenues from the Public	304	377
As Appropriated by Congress	136,363	125,243
Total Earned Revenue	**$1,669,323**	**$1,480,053**

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 2005 and 2004, MMS received $2,229 million and $1,347 million of revenues, respectively, of permanent indefinite appropriations that MMS subsequently provided to the states.

Note 14. Apportionment Categories of Obligations Incurred

The amounts of direct and reimbursable obligations incurred at MMS, are apportioned under Category B and were subject to annual apportionment by OMB. The obligation amounts match the Statement of Budgetary Resources, but do not match MMS's FACTSII Report (SF-133) in FY 2005 and FY 2004 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 2005 and 2004
(dollars in thousands)

Description	FY 2005	FY 2004
Direct Obligations	$1,810,450	$1,340,054
Reimbursable Obligations	1,588,204	1,702,182
Total Obligations Incurred	**$3,398,654**	**$3,042,236**

Note 15. 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 percent).

2. Under 16 U.S.C. 499, at the end of each fiscal year States receive a Forest Fund payment equal to 25 percent of all revenue obtained during that year as a result of activities occurring in each of the national forests situated in that State. The law requires a State's payment be based on national forest acreage, and where a national forest occurs 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 custodial 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 16. Legal Arrangements Affecting Use of Unobligated Balances

MMS's unobligated unavailable balances for FY 2005 and FY 2004 are $1.5 million and $1 million, respectively, and consist of expired authority. Unobligated balances, whose period of availability has expired are not available to fund new obligations but is available to pay for adjustments to obligations incurred prior to expiration. For a fixed appropriation account, the balance can be carried forward for five fiscal years after the period of availability ends. At the end of the fifth year, the account is closed and any remaining balance is canceled.

Note 17. Differences Between the Statement of Budgetary Resources and the Budget of the United States Government

The FY 2007 Budget of the United States Government with the FY 2005 'actuals' was not available at the time the annual report was prepared. The document is expected to be available in February 2006 and may be found at the Office of Management and Budget website, www.whitehouse.gov/omb.

The differences between the FY 2004 Statement of Budgetary Resources (SBR), the SF-133, and actual amounts for FY 2004 as reported in the FY 2006 Budget of the United States Government are greatly attributed to the unique reporting requirements for each report. The specific differences exist as presented on the table following a - e explanations:

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

b. 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.

c. A difference resulted on the Total Budgetary Resources line because the President's Budget did not include a "total budgetary resources available for obligation" line for funds 14X5003 – Mineral Leasing, 14X5243 – National Forest Fund, 14X5248 – Leases of Lands Acquired for Flood Control, Navigation, and Allied Purposes, and 14X8370 – Oil Spill Research; however, the MMS Combined Statement of Budgetary Resources includes these funds in the total budgetary resources. There is not a difference in the individual budgetary resource line items as both the President's Budget and the MMS Combined Statement of Budgetary Resources include the amount for funds 14X5003, 14X5243, 14X5248, and 14X8370.

d. 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 2004, the BLM amount that was included in the MMS SF-133 and Budget of the US Government was approximately $1 million.

e. Due to rounding, other small differences have resulted between the SBR, SF-133 and the Budget of the United States Government. 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.

(dollars in millions)	Amount per Statement of Budgetary Resources	Amount per Budget of the United States Government	Difference	Explana-tion
Budgetary Resources:				
Unobligated Balance:				
Beginning of Fiscal Year	$732	$731	$1	a
Spending Authority from Offsetting Collections	1,714	1,715	(1)	e
Recoveries of Prior Year Obligations	6	5	1	b
Total Budgetary Resources	**3,791**	**2,614**	**1,177**	**c, d, e**
Status of Budgetary Resources:				
Obligations	3,042	3,041	1	d
Unobligated Balance	748	747	1	e
Total Status of Budgetary Resources	**3,791**	**2,614**	**1,177**	**c, d, e**
Relationship of Obligations to Outlays:				
Outlays:				
Disbursements	2,893	2,892	1	d

Note 18. Dedicated Collections

MMS's dedicated collections include Environmental Improvement and Restoration Fund (EIRF) and Oil Spill Research (OSR).

Half of the Alaska Escrow Fund was distributed to MMS to initially fund EIRF. 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 twenty percent 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 $6.8 million and $5.3 million in FY 2005 and FY 2004, respectively. The remaining eighty percent 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.

The funding for OSR is appropriated from the Department of the Treasury managed Oil Spill Liability Trust fund (OSLTF) each year. The OSLTF is funded from oil taxes, interest on fund principal, cost recovery from responsible parties, and penalties. The OSR appropriation funds oil spill research, oil spill prevention, response planning activities, and regulation of oil spill financial responsibility. MMS is the principal federal agency funding offshore oil spill response research. The Oil Spill Response Research (OSRR) program supports research to improve the capabilities for detecting and responding to an oil spill in the marine environment. MMS is responsible for the planning, preparedness, and response-related activities related to oil and gas exploration, development, and productions seaward of the coastline.

The MMS also implements the financial responsibility provisions for Outer Continental Shelf Land Act (OCSLA) and Oil Pollution Act (OPA), which require companies responsible for certain offshore oil and gas facilities, in both Federal and State waters, to demonstrate their ability to pay the costs of facility oil spill discharge removal and damages. The amount transferred to MMS from the Department of the Treasury was $7 million in FY 2005 and FY 2004, respectively.

Dedicated Collections
As of and for the year ended September 30, 2005
(dollars in thousands)

	EIRF	Oil Spill
Assets		
Fund Balance with Treasury	$-	$6,872
Investments, Net	1,030,926	-
Accounts Receivable, Net	-	162
Total Assets	**$1,030,926**	**$7,034**
Liabilities		
Accounts Payable	$-	$1,652
Other Liabilities	-	83
Total Liabilities	**-**	**1,735**
Total Net Position	1,030,926	5,299
Total Liabilities and Net Position	**$1,030,926**	**$7,034**
Change in Net Position		
Net Position, Beginning of Fiscal Year	$1,001,654	$5,925
Change in Net Position:		
Non-Exchange Revenue - Interest	29,272	-
Transfers In/Out without Reimbursement	-	7,006
Exchange Revenue - Services Provided and Other	-	494
Program Expenses	-	(8,126)
Net Position, End of Fiscal Year	**$1,030,926**	**$5,299**

Note 18. Dedicated Collections (Continued)

Dedicated Collections
As of and for the year ended September 30, 2004
(dollars in thousands)

(dollars in thousands)	EIRF	Oil Spill
Assets		
Fund Balance with Treasury	$2	$6,866
Investments, Net	1,001,652	-
Accounts Receivable, Net	-	24
Total Assets	**$1,001,654**	**$6,890**
Liabilities		
Accounts Payable	$-	$771
Other Liabilities	-	194
Total Liabilities	**-**	**965**
Total Net Position	1,001,654	5,925
Total Liabilities and Net Position	**$1,001,654**	**$6,890**
Change in Net Position		
Net Position, Beginning of Fiscal Year	$977,522	$5,075
Change in Net Position:		
Non-Exchange Revenue - Interest	24,132	-
Transfers In/Out without Reimbursement	-	7,017
Exchange Revenue - Services Provided and Other	-	222
Program Expenses	-	(6,389)
Net Position, End of Fiscal Year	**$1,001,654**	**$5,925**

Note 19. 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 in unfunded liabilities that are not covered by budgetary resources, excluding custodial liabilities, and advance, deferred revenue, and deposit funds (see Note 10) are reported in the Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period section of the Statement of Financing. Due to a decrease in the Federal Employee Benefits - FECA Actuarial Liability between FY 2004 and FY 2003, this liability is reported in the FY 2004 Resources Used to Finance Items not Part of the Net Cost of Operations section of the Statement of Financing.

(dollars in thousands)

Liability	FY 2005	FY 2004	Increase/(Decrease)
Annual Leave Liability	$12,229	$11,613	$616
Other	1,572,672	973,636	599,036
Total	**$1,584,901**	**$985,249**	**$599,652**

(dollars in thousands)

Liability	FY 2004	FY 2003	Increase/(Decrease)
Annual Leave Liability	$11,613	$10,397	$1,216
Other	964,925	786,340	178,585
Total	**$976,538**	**$796,737**	**$179,801**

Note 20. Strategic Petroleum Reserve

During FY 2005 and FY 2004, MMS transferred to the Department of Energy (DOE) approximately 25.6 million and 38.4 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 arrangements 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 2005 and FY 2004 was approximately $1,195 million and $1,191 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 (projected production) from the suppliers as the actuals were not available. In addition, the value of the September oil is estimated based on August pricing.

Note 21. Custodial Distributions to MMS

MRM distributes custodial funds to MMS. These amounts fund payments to States, RIK and SPR transportation and administrative costs, and MMS operations. The amount used to fund operations is legislated by Congress as part of MMS's Annual Appropriation.

Fiscal Years 2005 and 2004
(dollars in thousands)

Distribution to MMS	FY 2005	FY 2004
Payments to States	$1,632,632	$1,168,295
RIK and SPR Costs	21,751	32,000
Revenues to Fund Operations	107,708	100,230
Total Distribution	**$1,762,091**	**$1,300,525**

Required Supplementary Information

(Unaudited, see accompanying auditors' report)

Supply Ships delivering supplies to Medusa Spar

U.S. Department of the Interior
Minerals Management Service
Combining Statement of Budgetary Resources
For the year ended September 30, 2005
(dollars in thousands)

	Royalty and Offshore Mineral Management	Mineral Leasing	Oil Spill Research	Interior Franchise Fund	Other	2005
Budgetary Resources:						
Budget Authority:						
Appropriations Received	$ 169,175	$ 1,620,107	$ 7,103	$ -	$ 12,525	**$ 1,808,910**
Net Transfers, Current Year Authority	3,344	-	-	-	-	**3,344**
Unobligated Balance:						
Beginning of Fiscal Year	13,432	-	139	734,961	-	**748,532**
Spending Authority From Offsetting Collections:						
Earned						
Collected	140,868	-	356	1,574,668	-	**1,715,892**
Receivable From Federal Sources	81	-	138	(1,693)	-	**(1,474)**
Change in Unfilled Customer Orders						
Advance Received	(6,492)	-	(113)	(58,036)	-	**(64,641)**
Without Advance From Federal Sources	(539)	-	(39)	(9,787)	-	**(10,365)**
Subtotal: Spending Authority From Offsetting Collections	133,918	-	342	1,505,152	-	**1,639,412**
Recoveries of Prior Year Obligations	5,923	-	272	-	-	**6,195**
Temporarily Not Available Pursuant to Public Law	-	-	(99)	-	-	**(99)**
Permanently Not Available	(2,467)	-	-	-	-	**(2,467)**
Total Budgetary Resources	$ 323,325	$ 1,620,107	$ 7,757	$ 2,240,113	$ 12,525	**$ 4,203,827**
Status of Budgetary Resources:						
Obligations Incurred:						
Direct (Category B)	$ 170,748	$ 1,620,107	$ 7,070	$ -	$ 12,525	**$ 1,810,450**
Reimbursable (Category B)	136,357	-	344	1,451,503	-	**1,588,204**
Total Obligations Incurred (Note 14)	307,105	1,620,107	7,414	1,451,503	12,525	**3,398,654**
Unobligated Balance:						
Apportioned	14,762	-	343	788,610	-	**803,715**
Unobligated Balance not Available	1,458	-	-	-	-	**1,458**
Total Status of Budgetary Resources	$ 323,325	$ 1,620,107	$ 7,757	$ 2,240,113	$ 12,525	**$ 4,203,827**
Relationship of Obligations to Outlays:						
Obligations Incurred	$ 307,105	$ 1,620,107	$ 7,414	$ 1,451,503	$ 12,525	**$ 3,398,654**
Obligated Balance, Net, Beginning of Fiscal Year	87,605	-	6,728	658,671	-	**753,004**
Obligated Balance, Net, End of Fiscal Year:						
Accounts Receivable	598	-	162	4,673	-	**5,433**
Unfilled Customer Orders From Federal Sources	586	-	42	167,649	-	**168,277**
Undelivered Orders	(61,555)	-	(5,022)	(486,228)	-	**(552,805)**
Accounts Payable	(28,505)	-	(1,710)	(230,152)	-	**(260,367)**
Total Obligated Balance, Net, End of Fiscal Year	(88,876)	-	(6,528)	(544,058)	-	**(639,462)**
Less: Spending Authority Adjustments	(5,465)	-	(371)	11,480	-	**5,644**
Outlays:						
Disbursements	300,369	1,620,107	7,243	1,577,596	12,525	**3,517,840**
Collections	(134,375)	-	(243)	(1,516,631)	-	**(1,651,249)**
Net Outlays Before Offsetting Receipts	165,994	1,620,107	7,000	60,965	12,525	**1,866,591**
Less: Offsetting Receipts	-	(1,620,107)	-	-	(450,010)	**(2,070,117)**
Net Outlays (Receipts)	$ 165,994	$ -	$ 7,000	$ 60,965	$ (437,485)	**$ (203,526)**

U.S. Department of the Interior
Minerals Management Service
Combining Statement of Budgetary Resources
For the year ended September 30, 2004

(dollars in thousands)

	Royalty and Offshore Mineral Management	Mineral Leasing	Oil Spill Research	Interior Franchise Fund	Other	2004
Budgetary Resources:						
Budget Authority:						
Appropriations Received	$ 165,316	$ 1,162,955	$ 7,105	$ -	$ 5,340	**$ 1,340,716**
Unobligated Balance:						
Beginning of Fiscal Year	11,119	-	122	720,544	-	**731,785**
Spending Authority From Offsetting Collections:						
Earned						
Collected	128,463	-	207	1,396,542	-	**1,525,212**
Receivable From Federal Sources	294	-	14	(17,055)	-	**(16,747)**
Change in Unfilled Customer Orders						
Advance Received	7,310	-	98	264,506	-	**271,914**
Without Advance From Federal Sources	(91)	-	10	(65,872)	-	**(65,953)**
Subtotal: Spending Authority From Offsetting Collections	135,976	-	329	1,578,121	-	**1,714,426**
Recoveries of Prior Year Obligations	6,172	-	53	-	-	**6,225**
Temporarily Not Available Pursuant to Public Law	-	-	(88)	-	-	**(88)**
Permanently Not Available	(2,296)	-	-	-	-	**(2,296)**
Total Budgetary Resources	$ 316,287	$ 1,162,955	$ 7,521	$ 2,298,665	$ 5,340	**$ 3,790,768**
Status of Budgetary Resources:						
Obligations Incurred:						
Direct	$ 164,701	$ 1,162,955	$ 7,058	$ -	$ 5,340	**$ 1,340,054**
Reimbursable	138,154	-	324	1,563,704	-	**1,702,182**
Total Obligations Incurred	302,855	1,162,955	7,382	1,563,704	5,340	**3,042,236**
Unobligated Balance:						
Apportioned	12,663	-	139	734,961	-	**747,763**
Unobligated Balance not Available	769	-	-	-	-	**769**
Total Status of Budgetary Resources	$ 316,287	$ 1,162,955	$ 7,521	$ 2,298,665	$ 5,340	**$ 3,790,768**
Relationship of Obligations to Outlays:						
Obligations Incurred	$ 302,855	$ 1,162,955	$ 7,382	$ 1,563,704	$ 5,340	**$ 3,042,236**
Obligated Balance, Net, Beginning of Fiscal Year	79,518	-	5,838	442,008	-	**527,364**
Obligated Balance, Net, End of Fiscal Year:						
Accounts Receivable	517	-	25	6,365	-	**6,907**
Unfilled Customer Orders From Federal Sources	1,125	-	80	177,436	-	**178,641**
Undelivered Orders	(70,737)	-	(6,006)	(605,109)	-	**(681,852)**
Accounts Payable	(18,510)	-	(827)	(237,363)	-	**(256,700)**
Total Obligated Balance, Net, End of Fiscal Year	(87,605)	-	(6,728)	(658,671)	-	**(753,004)**
Less: Spending Authority Adjustments	(6,375)	-	(75)	82,925	-	**76,475**
Outlays:						
Disbursements	288,393	1,162,955	6,417	1,429,966	5,340	**2,893,071**
Collections	(135,773)	-	(305)	(1,661,048)	-	**(1,797,126)**
Net Outlays Before Offsetting Receipts	152,620	1,162,955	6,112	(231,082)	5,340	**1,095,945**
Less: Offsetting Receipts	-	(1,162,955)	-	-	(264,213)	**(1,427,168)**
Net Outlays (Receipts)	$ 152,620	$ -	$ 6,112	$ (231,082)	$ (258,873)	**$ (331,223)**

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. In FY 2005, DoD and the military service branches accounted for $1,012 million (68.6%) and $917.2 million (56.8%) in FY 2004, while the Civilian Agencies represented $464.4 million (31.5%) in FY 2005 and $697.5 million (43.2%) in FY 2004. The client base includes the Executive Office of the President totaling $21.5 million (1.5%) and the Department of Defense at $287.8 million (19.5%) in FY 2005 and $157.9 million (9.8%) and $296.3 million (18.4%) respectively in FY 2004.

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 2005 and FY 2004 was $4,389 thousand and $1,700 thousand, respectively. The major clients for FY 2005 include Social Security Administration at $1,457 thousand (33%), Department of the Army at $869 thousand (20%), and Department of Health and Human Services at $696 thousand (16%). Major clients for FY 2004 include US Army at $842 thousand (50%) and Department of the Interior at $320 thousand (19%).

Interior Franchise Fund (dollars in thousands)	2005	2004
Assets **Intragovernmental Assets:**		
Fund Balance with Treasury	$1,332,667	$1,393,632
Accounts and Interest Receivable, Net	4,673	6,370
Advances and Prepayments	153	1,283
Total Intragovernmental Assets	**1,337,493**	**1,401,285**
Accounts and Interest Receivable, Net	249	292
Advances and Prepayments	2	2
Total Assets	**$1,337,744**	**$1,401,579**
Liabilities		
Intragovernmental Liabilities:		
Accounts Payable	1,348	2,821
Accrued Payroll and Benefits	96	54
Advances and Deferred Revenue	1,078,949	1,136,985
Total Intragovernmental Liabilities	**1,080,393**	**1,139,860**
Accounts Payable	227,905	234,060
Other:		
Accrued Payroll and Benefits	802	433
Advances and Deferred Revenue	2	2
Total Liabilities	**$1,309,102**	**$1,374,355**
Net Position		
Cumulative Results of Operations	28,642	27,224
Total Liabilities and Net Position	**$1,337,744**	**$1,401,579**

As authorized by the Government Management Reform Act (GMRA), which allows the use of retained funds for the improvement and implementation of Department financial management, the Interior Franchise Fund transferred $11 million, in FY 2005 and FY 2004, to Departmental Offices to meet the implementation costs of the Financial and Business Management System and the Enterprise Services Network. This transfer resulted in an $11 million dollar decrease to IFF net position that is not reflected in the table below.

Summary of Interior Franchise Fund Business Lines
For the year ending September 30, 2005
(dollars in thousands)

	Full Cost of Goods and Services Provided	Related Exchange Revenue	Excess of Exchange Revenues Over Full Cost
U.S. Films and Video Productions	$4,789	($4,389)	$400
GovWorks Acquisition Services	1,510,314	(1,522,965)	(12,651)
Total	**$1,515,103**	**($1,527,354)**	**($12,251)**

Summary of Interior Franchise Fund Business Lines
For the year ending September 30, 2004
(dollars in thousands)

	Full Cost of Goods and Services Provided	Related Exchange Revenue	Excess of Exchange Revenues Over Full Cost
U.S. Films and Video Productions	$1,700	($1,700)	$-
GovWorks Acquisition Services	1,330,907	(1,349,056)	(18,149)
Total	**$1,332,607**	**($1,350,756)**	**($18,149)**

Required Supplementary
Stewardship Information
(Unaudited, see accompanying auditors' report)

Museum Collections:

The Minerals Management Service maintains a collection of 54 objects in its administrative offices at five bureau locations. There were 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 assets within the collection are fully documented and are in good condition, as they are properly preserved and presentable to the public. The standards achieved by facilities that house collections are good indicators of the status of collections for which item-level condition data are not available. Our facilities that house museum collections are judged to be in good condition because they meet at least 70% of the Department's standards for managing museum collections (411 DM 3).

FY 2005 Status of Cataloging and Condition of Cataloged Museum Collections							
MMS Museum Collections	Beginning Collections	Additions	Withdrawals	Ending Collections	Condition of Facility Housing Collection		
					Good	Fair	Poor
Held at MMS Facilities	54	-	-	54	100%		

Investment in Research and Development:

The MMS manages the mineral resources on 1.76 billion acres of the Outer Continental Shelf (OCS) to ensure that exploration, development, and production activities are conducted in a manner that conserves natural resources, provides for the safety of offshore workers, and assures protection of the environment. Numerous laws, particularly the National Environmental Policy Act (NEPA), provide the basis for environmental assessment and study of impacts associated with OCS related activities. The OCS Lands Act (OCSLA) mandates the conduct of environmental studies needed for the assessment and management of potential environmental impacts on the human, marine, and coastal environments affected by oil, natural gas, or other mineral development. The Oil Pollution Act (OPA) of 1990 sets down specific areas of research 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. MMS research supports the prediction of potential environmental impacts and aids in development of mitigating measures to ensure safe, pollution-free operations. The Environmental Studies Program (ESP) provides environmental and socioeconomic information to support decision-making during all phases of the OCS minerals program. The Technology Assessment and Research (TA&R) program pursues engineering studies focusing on operational safety, pollution prevention, and effective spill response.

Significant Outcomes/Accomplishments in the MMS studies programs include:

Chemosynthetic Ecosystems. Detailed environmental information on the deep Gulf of Mexico is needed as the energy industry continues its search for producible oil and natural gas reservoirs beyond the shelf into the deep waters of the continental slope. The geological features that make the Gulf of Mexico an important petroleum province also provide the conditions that result in the existence of natural seeps and chemosynthetic communities. To meet management needs for environmental information, the ESP conducts interdisciplinary studies in deepwater areas of the Gulf of Mexico to describe the distribution and structure of the unique ecosystems and biogeochemical and physical processes that influence these biologic resources. The MMS Chemosynthetic Ecosystems research has revealed many intriguing facts about chemosynthetic communities and animals. Findings indicate that Gulf seep species studied to date have a very slow growth rate. Some of the larger tube-worms may be centuries old and are believed to be the oldest living animals on earth. When Gulf chemosynthetic communities are buried and suffocated by natural events such as turbidity flows, the same type of community will eventually grow back, given the same local geochemical conditions. ESP-funded researchers have documented community successions over a period of 2,000 years, including several periods of temporary extinction. Thus, the extraction of oil and gas from subsurface reservoirs is not predicted to deprive the communities of the necessary gasses for survival. Research results have been made available to the public through publication of final reports on the

MMS website, and many aspects of this research have been published in peer-reviewed scientific journals. Based on these findings, MMS has developed regulatory measures designed to protect the unique chemosynthetic communities from the physical effects of OCS mineral activities. MMS lease stipulations relating to chemosynthetic communities allow exploration for domestic energy resources to go forward on tens of thousands of OCS acres, while protecting those areas where geochemical conditions are likely to support dense populations of chemosynthetic life. In recognition of the need for a more comprehensive understanding of these communities and where they are found, new studies are planned to further enable MMS to protect the density and diversity of such communities.

OHMSETT – The National Oil Spill Response Test Facility. As part of its mandate to ensure that the best and safest technologies are used in offshore oil and gas operations, MMS operates a 10-million gallon test tank for two essential functions related to oil spill response planning: responder training and full-scale equipment testing. Providing training at OHMSETT ensures responders can be trained under realistic conditions with releasing oil into the sea. Most of the quantitative performance data on mechanical equipment used by industry, the U.S. Coast Guard, and the U.S. Navy to contain and cleanup spilled oil was obtained through OHMSETT testing and evaluation. MMS has upgraded testing capabilities to provide a controlled environment for cold water testing and training (with or without ice). As a result, OHMSETT is now able to simulate realistic broken ice conditions. Recent testing activities include evaluation of oil spill skimmers for collecting spilled oil in broken ice, cold water dispersant effectiveness tests, evaluations of viscous oil pumping equipment, basic research on the evaporation of oil and formation of emulsions, cold water oil spill response training, and evaluations of fast water oil spill response equipment.

MMS research activities are pursued in partnership with universities; private sector companies and associations; and Federal, State, and Foreign Government agencies – pursuing common goals in safety, environmental protection, and natural resource conservation.

Investment in Research and Development (in millions)						
	FY 2001	**FY 2002**	**FY 2003**	**FY 2004**	**FY 2005**	**TOTAL**
Applied	$31,0	$28.5	$29.4	$29.3	$30.2	$148.4
Total R&D Investment	**$31.0**	**$28.5**	**$29.4**	**$29.3**	**$30.2**	**$148.4**

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.