# Analysis of Financial Statements

To ensure the integrity of financial operations and the accuracy of financial data, Interior prepares audited financial statements for the Department as well as individual bureaus. The Department's principal financial statements include:

(1) Consolidated Balance Sheet;
(2) Consolidated Statement of Net Cost;
(3) Consolidated Statement of Changes in Net Position;
(4) Combined Statement of Budgetary Resources;
(5) Consolidated Statement of Financing; and
(6) Statement of Custodial Activity.

*Table 28* summarizes the objective of each financial statement.

Selected consolidating and combining financial statements are provided to assist in the analysis of key data. The Consolidating Statement of Net Cost is presented in Note 18 (see Notes to Principal Financial Statements); the Combining Statement of Budgetary Resources is presented in the Required Supplementary Information section of this report; and the Consolidating Balance Sheet and Consolidating Statement of Changes in Net Position are presented in the Other Supplementary Information section of this report.

The Department's goal is to achieve an unqualified (clean) audit opinion on its financial statements, without any findings related to deficiencies in internal control of financial reporting or any reported noncompliance with laws and regulations, including Federal Financial Management Improvement Act requirements.

Unqualified audit opinions provide independent, reasonable assurance to the public and other external users that the information being provided is reliable and accurate. The benefits of conducting financial statement audits and obtaining unqualified opinions are twofold. The audits:

- Ensure that quality data is provided to external parties and the public; and

- Ensure that financial documents and records used by management can withstand the rigors of the audit process.

TABLE 28

| Federal Financial Statements | |
|---|---|
| **Statement** | **Federal Objective** |
| Balance Sheet | The Balance Sheet is intended to present the Department's financial position—assets, liabilities, and net position—at the statement date. |
| Statement of Net Cost | The Statement of Net Cost is intended to demonstrate the costs of missions and programs accomplished by the Department for the taxpayer. |
| Statement of Changes in Net Position | The Statement of Changes in Net Position explains how the Net Cost to the taxpayers for the Department's operations was funded, and reports other changes in equity that are not included in the Statement of Net Cost. |
| Statement of Custodial Activity | The Statement of Custodial Activity presents financial information related to oil and gas royalties. |
| Statement of Budgetary Resources | Statement of Budgetary Resources provides information about how budgetary resources were made available as well as their status at the end of the period. |
| Statement of Financing | The Statement of Financing reports the differences and facilitates the understanding of the differences between the net cost of operations and the obligations of budget authority. |

Moreover, the discipline required to produce audited financial statements demands that appropriate management attention be directed to improving financial management and complying with applicable laws and regulation. It also shows external parties and the public how the Department utilizes the resources provided by Congress.

## Limitations of Financial Statements

Responsibility for the integrity and objectivity of the financial information presented in the financial statements lies with Interior management. The financial statements and supplemental schedules included in this report reflect the financial position and results of operation of the Department pursuant to the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. While these statements have been prepared from the books and records of Interior in accordance with generally accepted accounting principles (GAAP), the statements differ from financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The financial statements should be read with the realization that Interior is 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 subjected to enactment of appropriations.

## Net Costs of Operations

As shown on the Consolidated Statement of Net Cost, the total FY 2003 cost of Interior operations was $12,239 million, a decrease of $737 million from the FY 2002 cost of $12,976 million (*Table 29*).

The Consolidated Statement of Net Cost is divided into the following six major program segments:

- Protect the Environment and Preserve Our Nation's Natural and Cultural Resources
- Provide Recreation for America
- Manage Natural Resources for a Healthy Environment and a Strong Economy
- Provide Science for a Changing World
- Meet Our Trust Responsibilities to Indian Tribes and Our Commitments to Island Communities
- Reimbursable Activity and Other

Approximately 32% of Interior's total costs are directed toward "Protect the Environment and Preserve Our Nation's Natural and Cultural Resources" while 23% are provided to "Manage Natural Resources for a Healthy Environment and a Strong Economy." Resources devoted to "Meet Our Trust Responsibilities to American Indians and Our Commitments to Island Communities" account for approximately 19% of total costs (*Figure 32*).

Most costs incurred by the Department are directly related to providing services to the public. Costs associated with earning revenue from Federal agencies are approximately 15% of total expenses.

In addition, costs associated with Reimbursable and Other Activities are separately identified (see Revenues section for additional information). During FY 2003, the cost of Interior operations was impacted by an increase in revenue of approximately $1 billion, primarily due to an increase in the client base and contracts for the Franchise Fund operations. During FY 2003, the USGS experienced technical difficulties with a satellite used in operations, which is currently operating in a diminished capacity. The satellite was deemed to be impaired, and as a result, an $81.1 million impairment cost is reflected in the Statement of Net Cost.

TABLE 29

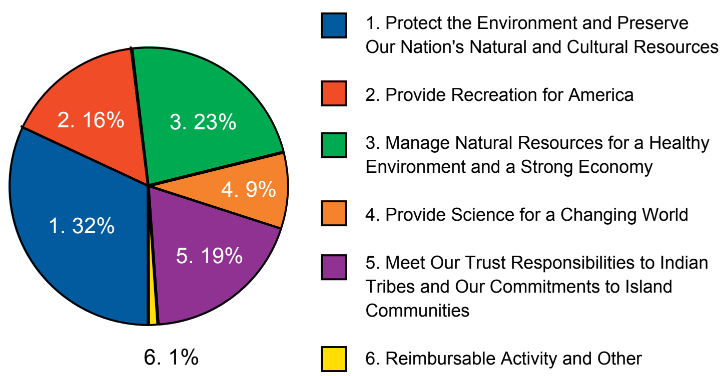
**Interior Change in Net Cost of Operations**
**(millions)**

| | FY 2003 | FY 2002 | Change | % Change |
|---|---|---|---|---|
| Protect the Environment and Preserve Our Nation's Natural and Cultural Resources | $3,848 | $3,624 | $224 | 6.2% |
| Provide Recreation for America | 1,944 | 1,998 | (54) | -2.7% |
| Manage Natural Resources for a Healthy Environment and a Strong Economy | 2,773 | 3,409 | (636) | -18.7% |
| Provide Science for a Changing World | 1,108 | 1,119 | (11) | -1.0% |
| Meet Our Trust Responsibilities to Indian Tribes and Our Commitments to Island Communities | 2,305 | 2,656 | (351) | -13.2% |
| Reimbursable Activity and Other | 180 | 170 | 10 | 6.0% |
| Asset Impairment | 81 | - | 81 | - |
| Totals | $12,239 | $12,976 | (737) | -5.7% |

The Department is routinely subject to various types of litigation. The vast majority of these lawsuits occur in the normal course of business and are reflected in the appropriate program costs. Legal and environmental contingencies are discussed more fully below.

FIGURE 32

FY 2003 Net Cost of Operations




## Revenues

In general, Interior's strategic goals are intended to be funded by general government funds derived from tax receipts and other sources. However, other fees and collections are supporting an increasing number of Departmental activities. Federal government revenues are classified as either (1) Exchange Revenue or (2) Non-Exchange Revenue. Exchange revenue occurs when both parties to the transaction receive value (e.g., the government sells maps or other products and services to the public for a price). Non-Exchange Revenue occurs when only one party receives value (e.g., donations to the government from the public or government demands for payment through taxes, fines and penalties). In accordance with Federal accounting standards, only Exchange Revenues are presented on the Consolidated Statement of Net Cost so that the statement reflects, to the extent possible, the net cost to the taxpayer of the agency operations.

Total Interior revenues from the public derive from sales of hydroelectric power, entrance fees at parks and wildlife refuges, sales of maps, and other products and services that are directly related to the operating responsibility of the Department. Revenues collected from other Federal agencies consist of reimbursable revenues from activities such as construction, engineering, and other technical services. In addition to the exchange revenues presented in the Statement of Net Cost, the Department also collects mineral leases revenues on behalf of the Federal government. These are presented in the Statement of Custodial Activity rather than the Statement of Net Cost.

In FY 2003, the Department earned approximately $1,544 million in revenues from the public and approximately $2,318 million in revenue from other

TABLE 30

**Interior Costs and Revenues to the Public and Federal Agencies (in millions)**

| | FY 2003 | FY 2002 | Change | % Change |
|---|---|---|---|---|
| Cost of services provided to the Public | $13,675 | $14,194 | ($519) | -3.9% |
| Revenue earned from the Public | 1,544 | 1,258 | 286 | 22.7% |
| Cost of services provided to Federal agencies | 2,345 | 1,516 | 829 | 54.7% |
| Revenue earned from Federal agencies | $2,318 | $1,475 | $843 | 57.1% |

Federal entities for a total of $3,862 million (*Table 30*). This is an increase of about $1,129 million from FY 2002. In FY 2002, approximately $1,258 million was earned in revenues from the public and approximately $1,475 million was earned in revenue from other Federal entities for a total of $2,733 million.

Bureau revenue details include revenue from The Southern Nevada Public Land Management Act (SNPLMA), which was enacted in October 1998 and authorizes BLM to sell public land tracts that are interspersed with or adjacent to private land in the Las Vegas Valley. During FY 2003, BLM had larger land sales than in any previous fiscal year and was able to invest almost $280 million of the proceeds from these sales. Additionally, BLM collected almost $3 million of interest revenue related to the SNPLMA investments. Finally, revenues earned by the Interior Franchise Fund increased by $717 million in FY 2003 as a result of an increase in the Franchise Fund operations.

In addition to earned revenues reported on the Statement of Net Cost, the Department collects various non-exchange revenues. Non-exchange revenues are those such as taxes, fines and penalties which the government collects as a result of its sovereign powers rather than as a result of providing a good or service for a fee. Donations to the Department are also reported as non-exchange revenues. Non-exchange revenue including taxes and donations increased from $1,118 in FY 2002 to $1,159 million in FY 2003.

Revenues earned may either be retained in the Department to further Interior's mission or returned to the General Fund of the Treasury. In either case, these revenues offset the taxpayer's investment in the Department. In FY 2003 and FY 2002, the Department returned $31 and $34 million to the General Fund of the Treasury.

### Custodial Mineral Lease Revenues

Mineral leasing revenues reported on the Statement of Custodial Activity totaled $8,247 and $6,593 million in FY 2003 and FY 2002, respectively, and include Outer Continental Shelf and onshore oil, gas, and mineral sales and royalties.

In accordance with Federal accounting standards, these receipts are presented in the Department's Statement of Custodial Activity since the collections are considered to be revenue of the government as a whole rather than of the Department. In FY 2003 and FY 2002, respectively, $2,948 and $2,397 million was distributed to Interior programs, and $5,420 and $4,509 million was distributed to other entities, primarily Federal and State treasuries, and Indian tribes and organizations. The $1,654 million increase between FY 2003 and FY 2002 is primarily due to national and world economic conditions impacting oil and gas production. The distributions to the various Federal and non-Federal recipients are determined by formula and fluctuate in accordance with custodial receipts.

The Department collects a portion of revenue as royalties-in-kind for transfer to the Strategic Petroleum Reserve. The Strategic Petroleum Reserve revenues increased in FY 2003 as Interior received approximately 38.2 million barrels in FY 2003 at the request of the Strategic Petroleum Reserve while Interior only received 11.2 million barrels in FY 2002.

Distributions to Interior programs reported in the Statement of Custodial Activity differ from Royalties Retained reported on the Statement of Changes in Net Position because distributions are reported on a cash basis whereas the Royalties Retained are reported on an accrual basis.

## Budgetary Resources

The Department receives most of its funding from general government funds administered by the

FIGURE 33

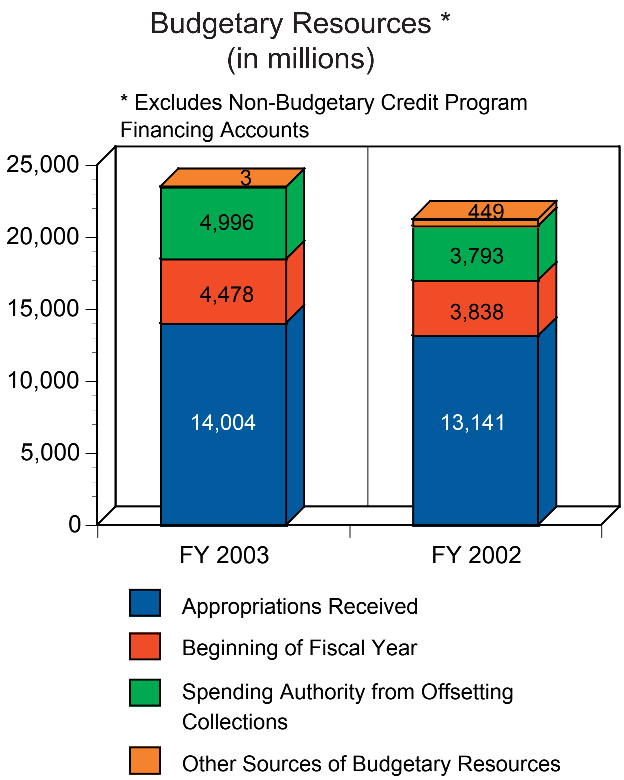
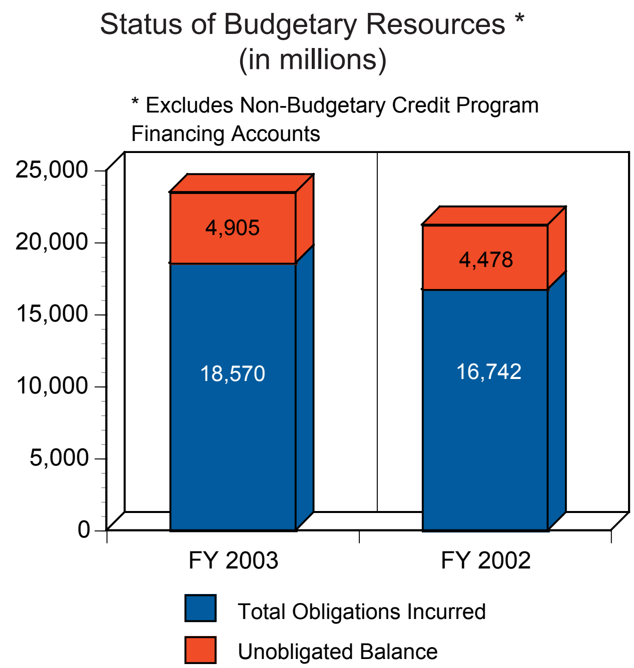



FIGURE 34




Treasury Department and appropriated for Interior's use by Congress. These resources consist of the balance at the beginning of the year, appropriations received during the year, and spending authority from offsetting collections as well as other sources of budgetary resources (*Figure 33*).

Since budgetary accounting rules and financial accounting rules may recognize certain transactions and events at different points in time, Appropriations Used in any given period as reported on the Consolidated Statement of Changes in Net Position will not match expenses for that period.

The Combined Statement of Budgetary Resources provides information on the budgetary resources that were made available to the Department for the year and the status of those resources at the end of the fiscal year. Obligations of $18,570 and $16,742 million were incurred in FY 2003 and FY 2002 on total budgetary resources of $23,475 and $21,220 million, respectively (*Figure 34*). The increase in Total Budgetary Resources is due primarily to an increase in Spending Authority from Offsetting Collections resulting from increased activity in Interior's Franchise Fund. This budgetary information is presented according to budgetary accounting principles designed to recognize the obligation of funds according to legal requirements, which in many cases is prior to the occurrence of an accrual-based transaction.

Appropriations Received reported in the Statement of Budgetary Resources differ from Appropriations Received reported in the Statement of Changes in Net Position due to Special and Trust fund appropriated receipts. These are shown as appropriations received in the budgetary statement but are reported based on the nature of the receipt in the proprietary statements as exchange revenue, non-exchange revenue or transfers.

## Budgetary and Financial Accounting

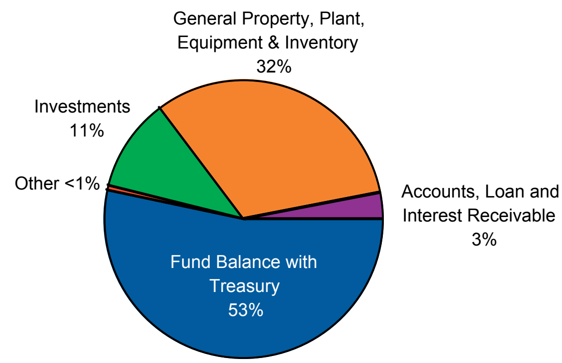
The Statement of Financing reconciles the accrual-based and budgetary-based information. The major factors impacting the FY 2003 Statement of Financing as compared to FY 2002 include an increase in obligations incurred in FY 2003 of $1,830 million, and a decrease in net cost of operations of $737 million. The decrease in net cost of operations occurred because of decreases to liabilities that do not

TABLE 31

| Change in Interior Assets (in millions) | | | | |
|---|---|---|---|---|
| | FY 2003 | FY 2002 | Net Change | % Change |
| Fund Balance with Treasury and Cash | $28,698 | $26,877 | $1,821 | 6.8% |
| Investments | 5,793 | 5,488 | 305 | 5.6% |
| Accounts, Loan & Interest Receivable | 1,848 | 2,127 | (279) | -13.1% |
| General Property, Plant & Equipment and Inventory | 17,295 | 17,128 | 167 | 1.0% |
| Other | $332 | $337 | ($5) | -1.3% |

FIGURE 35

Types of FY 2003 Assets




require resources in the current period. The largest of these decreases were in environmental and disposal liability and in future expenses for current employees.

## Assets

The Consolidated Balance Sheet shows FY 2003 assets totaling $53,966 million, an increase of $2,009 million (3.9%) over the prior year's assets total of $51,957 million. *Table 31* and *Figure 35* summarize the Department's assets reflected in the Consolidated Balance Sheet. Fund Balance with Treasury of $28,698 and $26,877 million and net General Property, Plant, and Equipment and Inventory of $17,295 and $17,128 million stayed constant at approximately 32% of the Department's total assets for both FY 2003 and FY 2002. BOR accounts for approximately 77% of the DOI's Property, Plant and Equipment asset account and consist of diversion and storage dams, hydroelectric power plants, water conveyance facilities, recreational facilities and associated buildings, bridges and roads as well as related construction, maintenance, laboratory and scientific equipment.

A portion of the Fund Balance with Treasury amounting to $19,315 and $18,508 million in FY 2003 and FY 2002, respectively consists of various Conservation Funds and is reported as "restricted" as these funds are not presently available to Interior. Fund Balance with Treasury increased primarily because of an increase in advances from other Federal agencies for the Interior Franchise Fund and Working Capital Fund and because revenues exceeded transfers out and expenses for Reclamation Fund, LWCF, HPF, and AML.

The receivables for MRM decreased by $185 million due to a greater efficiency on the part of MMS to match production records and distribute cash appropriately at the end of FY 2003. Due to the Internet shutdown, there was a larger amount of undistributed cash in FY 2002 because the matching could not be accomplished. When the cash is not distributed, it is returned to Treasury and a corresponding receivable is recorded.

Most of Interior's Buildings, Structures, and Facilities are composed of dams and power and irrigation facilities managed by the Bureau of Reclamation. The remainder consists of buildings and other structures and facilities used in the Department's operations (e.g., visitor centers, fish hatcheries, and Bureau of Indian Affairs schools).

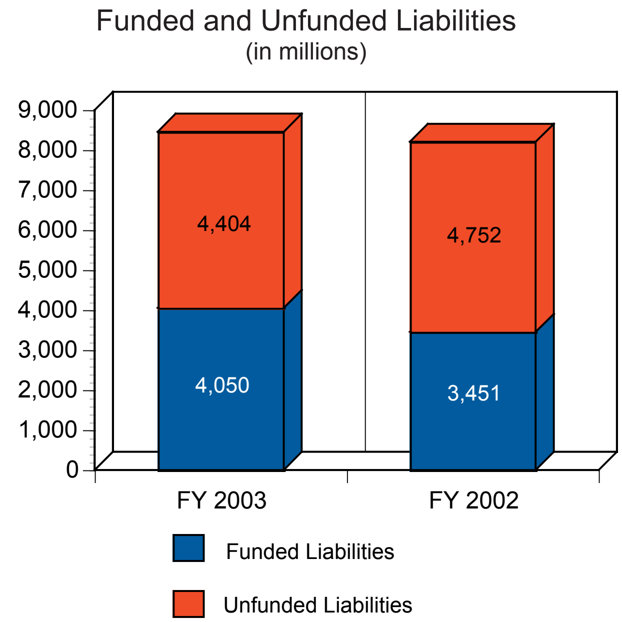
Interior's reported values for Property, Plant, and Equipment (PP&E) exclude stewardship property, such as land for national parks and national wildlife refuges, public domain land, historic buildings, and national monuments. These stewardship assets are priceless and do not have an identifiable financial value; therefore, monetary amounts cannot be assigned to them. An in-depth discussion of these assets is presented in the Required Supplementary Stewardship Information section of the report.

The Bureau of Reclamation, through the Reclamation Fund finances certain capital investment and operation and maintenance activities of the West-

TABLE 32

| Change in Interior Liabilities (in millions) | FY 2003 | FY 2002 | Net Change | % Change |
|---|---|---|---|---|
| Accounts Payable | $1,033 | 907 | 126 | 13.9% |
| Accrued Payroll and Benefits | 620 | 740 | (120) | -16.2% |
| Debt | 1,364 | 1,455 | (91) | -6.2% |
| Advances & Deferred Revenue | 1,238 | 597 | 641 | 107.2% |
| Custodial Liability | 763 | 818 | (55) | -6.7% |
| Aquatic Resource Amounts Due to Others | 390 | 371 | 19 | 5.0% |
| Federal Employees Compensation Act Liability | 712 | 659 | 53 | 8.2% |
| Environmental, Legal & Contingent Liabilities | 893 | 1,261 | (368) | -29.2% |
| Other Liabilities | 1,441 | 1,395 | 46 | 3.3% |
| Total | $8,454 | $8,203 | $251 | 3.1% |

FIGURE 36




ern Area Power Administration, a component entity of the Department of Energy. Western recovers the capital investment, associated interest, and other costs through power sales to the public, and deposits these recoveries back into the Reclamation Fund. The Bureau of Reclamation currently accounts for these appropriated transfers from the Reclamation Fund to Western as transfers to the Department of Energy, which are on the Consolidated Statement of Changes in Net Position in accordance with SFFAS No. 7 "Accounting for Revenue and Other Financing Sources," and using current Treasury Standard General Ledger guidance. The Department of Energy, however, views these payments as a loan from the Reclamation Fund. Net transfers between the Bureau of Reclamation and the Western Area Power Administration totaled $34,095 for FY 2003.

During FY 2003, OMB began a project to review the accounting and reporting of these types of appropriated transfers and plans to submit its findings and recommendations to the Accounting and Auditing Policy Committee (AAPC) of the Federal Accounting Standards Advisory Board for interpretation and guidance in FY 2004. The conclusions of the AAPC may require a change in accounting and reporting for these transactions.

## Liabilities and Net Position

Total liabilities of $8,454 million are shown on the Department's Consolidated Balance Sheet, representing an increase of 3.1% over liabilities of $8,203 million from the prior year. *Table 32* and *Figure 36* summarize the Department's liabilities reflected in the Consolidated Balance Sheet. Federal agencies by law cannot make any payments unless Congress has appropriated funds. The Department's "Funded Liabilities" are expected to be paid out of funds currently available to the Department. The Department's unfunded liabilities consist primarily of legal and environmental contingent liabilities and unfunded annual leave, and will be paid out of funds made available to the agency in future years. However, under accounting concepts, these are considered to be expenses recognized in the period in which the liability is established, regardless of budgetary funding considerations.

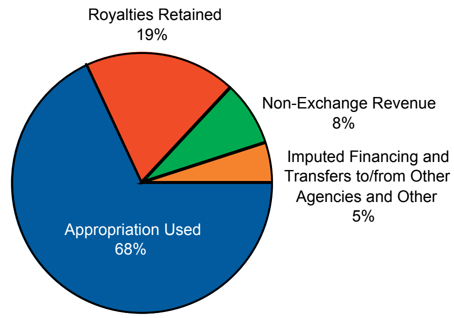
The primary reason for the increase in advances and deferred revenue is due to the procurement function at Fort Huachuca, which had a large increase in customer orders during FY 2003. Due to the war in Iraq, there were increased requirements from DOD and the Defense Advanced Research Project Agency, which resulted in advance payments

TABLE 33

| Change in Financing Sources Cumulative Results of Operations (in millions) | | | | |
|---|---|---|---|---|
| | FY 2003 | FY 2002 | Change | % Change |
| Appropriations Used | $9,520 | $9,211 | $309 | 3.3% |
| Royalties Retained | 2,583 | 2,541 | 42 | 1.6% |
| Non-Exchange Revenue | 1,159 | 1,118 | 41 | 3.7% |
| Imputed Financing and Transfers to/from Other Agencies & Other | 654 | 886 | (233) | -26.2% |
| Total | $13,915 | $13,756 | $159 | 1.2% |

FIGURE 37

FY 2003 Financing Sources




from contracts. There were also increases with GSA due to the E-government initiative.

Contingent liabilities include Interior's potential responsibility for cleanup of contaminated sites and legal claims brought against the Department. The Department's liability for financial statement purposes for environmental cleanup is for sites where the Department either caused contamination or is otherwise involved in such a way that it may be legally liable for some portion of the cleanup, and the environmental cleanup liability is probable and reasonably estimable. There are also numerous sites, including abandoned mines and illegal waste dumps, where parties have caused contamination on lands managed by the Department. Although such hazards do not constitute liabilities under Federal accounting rules, the Department will often, in its stewardship capacity, correct the environmental hazard. Wherever feasible the Department will continue to initiate collection efforts against the responsible parties. As of September 30, 2003, the Department has recognized $121 million for potential environmental cleanup liabilities and $772 million related to other claims and litigation. In addition to amounts recognized in the financial statements, the Department has a number of claims against it where the potential exposure to the Department cannot be estimated. These matters include claims related to the Department's management of Indian Trust Funds, explained in more detail at Note 15.

Contingent liabilities decreased due to the settlement of one large case and the change in likelihood of loss from probable to remote for another case. These two cases decreased the liability by approximately $300 million. The liability for estimated environmental cleanup costs decreased as a result of cleanup efforts and decreases in estimated remaining cleanup costs.

The Department's Net Position at the end of FY 2003 on the Consolidated Balance Sheet and the Consolidated Statement of Changes in Net Position was approximately $45,513 million, an increase of about $1,759 million or 4.0% from the prior year.

The Net Position of the Department consists of two components: (1) Unexpended Appropriations of $3,929 million and (2) Cumulative Results of Operations of $41,584 million.

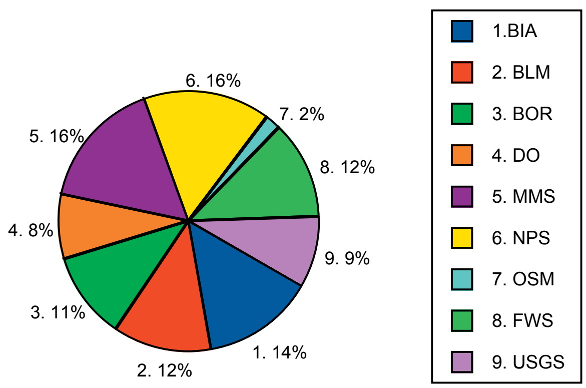
## Results of Operations

The Consolidated Statement of Changes in Net Position presents, on an accrual basis, the changes to the net position section of the balance sheet since the beginning of the fiscal year. *Table 33* and *Figure 37* shows the financing sources of $13,915 and $13,756 million received by the Department during FY 2003 and FY 2002. The Consolidated Statement of Net Cost reflects, on an accrual basis, revenue and expenses by bureau. *Figure 38* illustrates total expenses of $16,020 and $15,709 million by bureau in FY 2003 and 2002.

Transfers In/Out Without Reimbursement reflect the transfer of the Landsat 7 satellite that occurred in FY 2002 in the amount of $257 million. During

FIGURE 38

FY 2003 Cost by Bureau




FY 2003, the satellite experienced technical problems and is currently operating in a diminished capacity which reduced its value by $81.1 million. This reduction, in addition to normal depreciation brought the satellite's book value to $75.7 million for FY 2003. In addition, BLM's FY 2003 receipts from the National Park Service's Land and Water Conservation Fund was approximately $70 million less than in FY 2002. Additionally, the National Park Service's transfers of unobligated balances related to fire suppression were reduced by $156 million in FY 2003 because the FY 2003 transfers were from current budget authority and unobligated balances brought forward.

## Stewardship Assets

Interior is the Federal government's largest land-controlling agency, administering over 500 million acres of America's land mass and serves as steward for the natural and cultural resources associated with these lands. Parks and historic sites are the predominant categories of stewardship lands administered by the Department. Approximately 437 million acres of the 500 million acres are considered stewardship land. The 437 million acres do not include approximately 11 million acres of non-Federal land that cross or adjoin Interior-managed lands. Additional resources for which the Department has stewardship responsibility are natural heritage assets such as the national wilderness preservation system; national wild and scenic rivers; national natural landmarks and paleontological sites; cultural heritage assets, such as historical structures; cultural landscapes; archaeological sites; and stewardship lands.

The Stewardship assets managed by the Department tend to be constant from year to year, experiencing slight net increases due to new acquisitions (*Table 34*). Stewardship assets are discussed in the Required Supplementary Stewardship Information section of the report.

TABLE 34

Stewardship Land

| | Beginning Acres | Additions | Withdrawals | Ending Acres |
|---|---|---|---|---|
| BLM | 261,457,325 | 849,729 | (356,676) | 261,950,378 |
| NPS | 79,042,247 | 418,591 | (618,014) | 78,842,824 |
| FWS | 90,120,000 | 144,000 | 0 | 90,264,000 |
| BOR | 5,801,369 | 59,785 | 0 | 5,861,154 |
| BIA | 204,949 | 1,965 | (1,709) | 205,205 |
| Other | 12,140 | 241 | 0 | 12,381 |
| Total | 436,638,030 | 1,474,311 | (976,399) | 437,135,942 |

## Stewardship Investments

Stewardship investments, as defined for Federal financial reporting, represent expenses charged to current operations that nevertheless are expected to benefit the Nation over time. The Department's Stewardship Investments include research and development programs, investment in education, and the purchase or construction of assets for which State, local or tribal governments and insular areas retain title. Stewardship investments are summarized on *Table 35*. Changes in the investments from FY 2002 to FY 2003 are due primarily to reduced funding available of stewardship investments.

TABLE 35

Stewardship Investments
(in millions)

| | FY 2003 | FY 2002 | Change | % Change |
|---|---|---|---|---|
| Non-Federal Physical Property | $645 | $748 | ($103) | -13.8% |
| Research and Development | 945 | 1,060 | (115) | -10.8% |
| Human Capital | 621 | 677 | (56) | -8.3% |
| Totals | $2,211 | $2,485 | ($274) | -11.0% |