Analysis of Financial Statements

To strengthen the integrity of financial operations and ensure the accuracy of financial data, Interior produces audited financial statements for the Department as well as individual bureaus. The Department's principal financial statements include: (1) Consolidated Balance Sheets; (2) Consolidated Statement of Net Cost of Operations; (3) Consolidated Statement of Changes in Net Position; (4) Statement of Custodial Activity; (5) Combined Statement of Budgetary Resources; and (6) Consolidated Statement of Financing. Overall, these statements summarize the financial activity and financial position of the Department. Additional financial information is presented in the Other Supplemental Information section of the report.

The Department's goal is to achieve unqualified (clean) audit opinions on all financial statements as well establish internal controls and comply with Federal Financial Management Improvement Act requirements. Unqualified audit opinions provide independent assurance to external users that the information being provided is reliable. The benefits of conducting financial statement audits and obtaining unqualified opinions are twofold: (1) ensuring that quality data is provided to external parties; and (2) ensuring that books and records used by management can withstand the rigors of the audit process.

Moreover, the discipline required to produce audited annual financial statements demands that appropriate management attention be directed to improving financial management and complying with applicable laws and regulations.

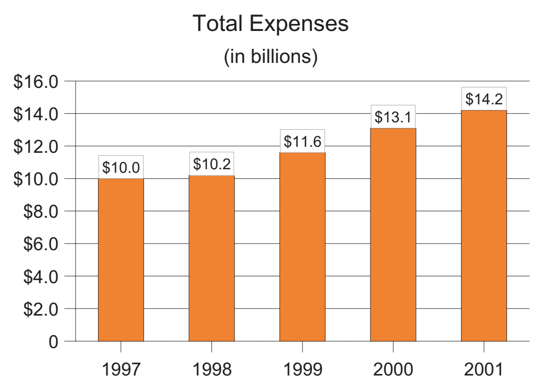
In 2001, the Department's consolidated financial statements and all bureaus that published financial statements received unqualified audit opinions on their financial statements except for the U.S. Geological Survey. The independent auditor was not able to render an opinion on USGS's financial statements.

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 financial 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 guidance provided by the Office of Management and Budget and the Federal Accounting Standards Advisory Board, the statements differ from financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The financial statements should be read with the realization that 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.

Expenses

As indicated in the Consolidated Statement of Net Cost of Operations, the 2001 gross cost of Interior operations, before earned revenue, was approximately $14.2 billion, an increase of 8.7 percent over 2000. The increase was due primarily to the additional availability of resources from an increase in current budget and spending authority from offsetting collections. An analysis of operating expenses shows that approximately 21 percent was for protecting the environment and preserving the Nation's natural and cultural resources, 24.3 percent was for managing natural resources for a healthy environment and a strong economy, 23.1 percent was for meeting responsibilities to American Indians and commitments to island communities, and the balance was for providing recreation for America, providing science for a changing world, and other program activities.

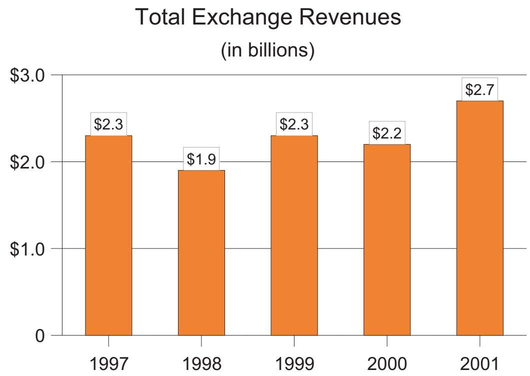


Revenues

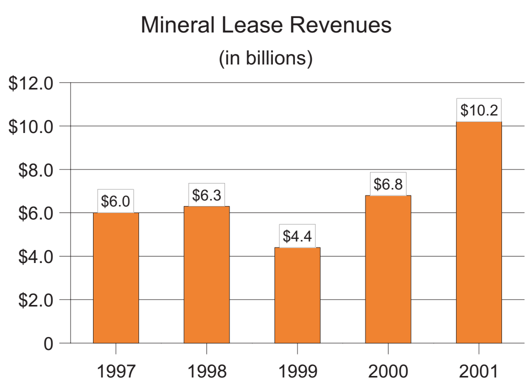
In general, Interior's strategic goals are intended to be funded by general government funds derived from tax receipts and other sources. However, an increasing number of departmental activities are being supported by other fees and collections.

Federal government revenue is classified as either Exchange Revenue or 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). Only Exchange Revenues are presented on the Consolidated Statement of Net Cost of Operations so that the statement reflects, to the extent possible, the net cost to the taxpayer of agency operations.

Interior's 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 responsibilities of the Department. Approximately $2.7 billion of revenues were collected and were either retained in the Department after congressional appropriation to further Interior's mission, or were returned to the General Fund of the Treasury. These revenues offset the taxpayers' investment in the Department. This represents an increase of approximately 21.1 percent from 2000.



During 2001, Interior collected over $10.2 billion in mineral leasing revenue, an increase of approximately 50 percent over 2000, from Outer Continental Shelf and onshore oil, gas, and mineral lease sales and royalties, making Interior one of the largest collectors of revenue in the federal government. These receipts are presented on the Department's Statement of Custodial Activity since these collections, under federal accounting rules, are considered to be revenue of the government as a whole rather than of the Department. The revenues are distributed primarily to federal and state treasuries, Indian tribes and allottees, the Land and Water Conservation Fund, and the Historic Preservation Fund.



Budgetary Resources

The Department receives most of its funding from general government funds administered by the Treasury Department and appropriated for Interior's use by Congress.

Interior's enacted 2001 current appropriations budget was $10.4 billion, an increase of approximately 22 percent from 2000. The Total Budgetary Resources available for use in 2001 was $19.9 billion, a increase of approximately 17 percent from 2000. This amount includes Budget Authority; Unobligated Balances – Beginning of Period; and Spending Authority from Offsetting Collections. Spending Authority from Offsetting Collections was $2.8 billion, an increase of about 15 percent from 2000.

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 exactly match expenses for that period.

$ in billions	Current Appropriations	Budget Authority *	Spending Authority from Offsetting Collections	Total Budgetary Resources Available for Use
1998	$8.2	$9.9	$1.9	$16.1
1999	$8.1	$10.3	$2.8	$18.1
2000	$8.5	$11.4	$2.4	$17.1
2001	$10.4	$13.8	$2.8	$19.9

* Includes permanent appropriations and prior year funds not available for current year obligations.

Assets

Approximately 33 percent of the Department's $50.2 billion in assets (see Consolidated Balance Sheets) is composed of Property, Plant, and Equipment.

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. Although these stewardship assets are priceless, they do not have an identifiable financial value and therefore cannot be adequately presented on a numerically based balance sheet. An in-depth discussion of these assets is presented in the Required Supplementary Stewardship Information section of the report.

The Fund Balance with Treasury - General is $7.5 billion, an increase of 21.4 percent over 2000. These funds are in agency accounts maintained by Treasury. The Treasury Department functions like a bank, and Interior's Fund Balance with Treasury is analogous to a checking account. The portion of Fund Balance with Treasury available to the Department for spending at any point in time depends on the terms of appropriation language and other factors.

The Department has Restricted Assets for 2001 in the amount of $21.9 billion. These amounts derive primarily from royalties and lease payments generated from oil and gas extracted from the Outer Continental Shelf. Restricted Assets cover Fund Balance with Treasury, Cash, Investments, and Accounts Receivable associated with the Land and Water Conservation Fund, the Reclamation Fund, the Historic Preservation Fund, the Environmental Improvement, the Aquatic Restoration Fund, and custodial revenue pending distribution.

$ in billions	Fund Balance with Treasury	Cash, and Investments (Unrestricted)	Restricted Assets	Property, Plant, and Equipment	Other Assets
1998	$5.8	$4.2	$17.4	$17.3	$5.7
1999	$5.9	$4.4	$18.1	$16.8	$5.9
2000	$6.1	$2.7	$19.5	$16.6	$2.4
2001	$7.5	$3.0	$20.4	$16.5	$2.8

Liabilities and Net Position

Federal agencies, by law, cannot make any payments unless funds have been appropriated by Congress. The Department's unfunded liabilities (approximately $2.2 billion, or 31.6 percent of total liabilities) consist primarily of legal and environmental contingent liabilities and unfunded annual leave, both of which are considered expense and liability in the current period, but which will be paid out of funds made available to the agency in future years.

$ in billions	Funded Liabilities	Unfunded Liabilities
1997	$8.8	$1.1
1998	$9.0	$1.6
1999	$9.0	$1.6
2000	$4.4	$2.2
2001	$4.9	$2.2

Contingent liabilities reflect Interior's potential responsibility for cleanup of contaminated sites and for legal claims brought against the Department. The Department's liability for financial statement purposes for environmental cleanup is limited to those sites where Interior is or may be held to be legally liable for remediation of the hazard; for example, underground fuel tanks installed by the Department. In addition, there are numerous sites, including abandoned mines and illegal waste dumps, where other 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, Interior will initiate collection efforts against the responsible parties. The estimated liability excludes estimates of future sites where Interior will voluntarily correct environmental hazards. The Department has recognized $268 million for potential environmental cleanup liabilities and $480 million related to other claims and litigation.

The Net Position of the Department consists of two components: (1) Unexpended Appropriations and (2) Cumulative Results of Operations. The Unexpended Appropriations account reflects spending authority made available to the Department by congressional appropriation that has not yet been used by Interior. Cumulative Results of Operations reflects the net results of the Department's operations over time. In total, Interior's Net Position, as of September 30, 2001, is $43 billion, of which $3.8 billion is Unexpended Appropriations.