

**FINANCIAL STATEMENTS,
NOTES TO FINANCIAL
STATEMENTS, AND OTHER
REQUIRED ACCOUNTABILITY
REPORT INFORMATION**

COMPLIANCE WITH LEGAL AND FINANCIAL REQUIREMENTS

The following provides information on OSM's compliance with:

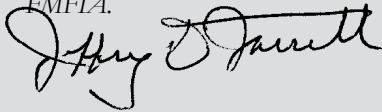
- Federal Managers' Financial Integrity Act (FMFIA);
- Federal Financial Management Improvement Act (FFMIA);
- Other key legal and regulatory requirements

Federal Managers' Financial Integrity Act (FMFIA)

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

Assurance Statement

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



Jeffrey Jarrett, Director

Management Control Review

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

For 2003, we conducted assessments of selected programs and administrative functions sufficient to ensure adequacy of controls in place. Areas for improvement were identified and corrective actions are being implemented. In general, we found our management controls adequate to safeguard our programs and systems against waste, fraud, abuse, and mismanagement. No material weaknesses were identified (see Figure 9).

**Figure 9
2003 Management Control Reviews**

Review	Scope	Results
Space Management-Leased Space	Determine the amount of usable square footage at each OSM location by measuring the offices and rooms; and analyze the needs requirements of each OSM location to determine if the space provided meets or exceeds the requirements.	No Material Weaknesses Noted
Printing, Publications and Reprographics	Determine if the OSM printing, publications, and reprographics programs have adequate management controls to prevent fraud, waste, abuse and mismanagement of Federal funds. A comprehensive review of controls over all high risk areas was performed.	No Material Weaknesses Noted
Personal Property Performance Assessment	Identify what controls or processes exist to ensure all field office staff are entering and maintaining required personal property information into the PALS; Analyze existing controls or processes to determine overall effectiveness.	No Material Weaknesses Noted
Federal Reclamation Program	Examine the Division's processes to assure compliance with the National Environmental Policy Act while administering the Federal Abandoned Mined Land Emergency program.	Minor improvements were commended, no material weaknesses were found.
Computer Centers	Tests were conducted on the Computer Center at DFM to complete an Initial Assessment (IA) security review and to provide a reasonable assurance of detecting weakness of a material or significant nature. The systems reviewed included ABACIS, AFBACS/FEEBACS, AVS, IDEAS, Condors, OSM-1 Electronic Filing, MAPS, GIFTS and their LAN General Support System Support.	No Material Weaknesses Noted
Sensitive Automated Information Systems (General Support Systems)	Determine if adequate controls for the ARCC, MCRCC, and WRCC Local Area Networks are in place to prevent waste, fraud and abuse, and mismanagement of Federal funds; and to determine if they are being operated in an effective, efficient and secure manner.	No Material Weaknesses Noted
Sensitive Automated Information Systems (Major Application)	Determine if adequate controls for the Grants Information Financial Tracking System (GIFTS) are in place to prevent waste, fraud and abuse, and mismanagement of Federal funds; and to determine if they are being operated in an effective, efficient and secure manner.	No Material Weaknesses Noted
Acquisition Management Review	On-site acquisition review of OSM's contracting activity located at the Division of Financial Management in Denver, CO. Examined the customer service, timeliness and procurement support provided by DFM procurement staff.	No Material Weaknesses Noted
Fleet Management	Assess OSM options regarding leasing vs. owning vehicles. The major components included: identify what controls or processes exist to ensure documentation and approvals are in place prior to establishing a Home-To-Work Program; and analyze existing controls or processes to determine overall effectiveness of maintaining a safe and serviceable fleet within targeted review of Home-to-Work and Fleet Management within OSM.	No Material Weaknesses Noted

Federal Financial Management Improvement Act (FFMIA)

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

Based on the results of OSM's independent financial statement audit for FY 2003, OSM can conclude that it is in substantial compliance with the U.S. Government Standard General Ledger at the transaction level, and with Federal accounting standards as required by the FFMIA. As a result of reportable conditions identified in the FY 2003 financial statement audit, however, OSM concluded that its financial management systems did not substantially comply with all Federal financial management systems requirements. OSM has reported this non-compliance with the financial management system component of the FFMIA and has established a remediation plan to achieve substantial compliance.

Other Key Legal and Financial Regulatory Requirements

Prompt Payment Act

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

- Credit cards were used to cut through red tape and expedite payment. Almost 86 percent of purchase transactions were made with credit cards in FY 2003, and the agency continues to promote their increased use, and
- Electronic funds transfer (EFT) was used to make 99.95 percent of the agency's vendor payments covering 100% of the dollar amount paid.

Debt Collection Improvement Act

OSM collected over 99.75 % of the Abandoned Mine Land Reclamation Fees due this year, for a total of \$ 282.6 million. This is the result of an integrated fee compliance program that works with the coal mining industry to provide clear guidance on fee payment and reporting issues, as well as active follow-up through audits and several other compliance activities. The current uncollected outstanding accounts receivable balance is \$3.0 million, comprised of \$ 2.7 million in AML Fees and Audit debt, and \$ 0.3 million in civil penalties. The \$ 3.0 million balance includes accounts that may not be collectible. After deducting a \$ 1.7 million estimate for uncollectible receivables, we estimate that \$ 1.3 million should be collectible.

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

Civil Monetary Penalty Act

OSM has increased the assessment amounts of civil monetary penalties in accordance with the Act, and is in compliance. The agency issues civil monetary penalties for violations of the Surface Mining Control and Reclamation Act.

DISCUSSION AND ANALYSIS OF THE FINANCIAL STATEMENTS

Objectives of Financial Reporting

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

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

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

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

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

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

Limitations of the Financial Statements

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

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

Significant Financial Statement Issues

OSM was involved in financial transactions during the year that resulted in significant changes in certain line items on the financial statements between FY 2003 and FY 2002.

OSM's 2003 statements include an accrued accounts receivable from the United Mine Worker's Combined Benefit Fund in the amount of \$33.7 million. This receivable can be classified as an adjustment to OSM's annual payment to the UMWA-CBF. This adjustment resulted from the Social Security Administration's reassignment of certain beneficiaries and an over payment of estimated AML Fund interest earnings due to declining interest rates during FY 2003. Please see Notes 1.G, 6, 12, and 18 for additional information.

OSM's estimates for contingent legal liabilities resulting from pending litigation against OSM have been significantly revised upwards during FY 2003 by the amount of \$43.5 million. The U.S. Treasury's Judgment Fund would likely bear most of the costs incurred to pay any judgments or settlements and the resultant outcomes should not materially affect OSM's future financial condition. Please see Notes 10 and 12 for additional information.

Net Position Analysis

OSM's Total Net Position at the end of FY 2003 was \$1.9 billion, an increase of approximately \$22 million from FY 2002. OSM's Net Position consists of Unexpended Appropriations and Cumulative Results of Operations. OSM's Unexpended Appropriations remained relatively constant from the previous year while the \$22 million increase occurred in Cumulative Results of Operations. OSM's routine operations as well as the significant events described above contributed to the overall increase in net position.

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

As of September 30, 2003 and 2002
(dollars in thousands)

	2003	2002
ASSETS (Note 2)		
Intragovernmental Assets:		
Fund Balance with Treasury (Notes 3 and 18)	\$42,763	\$47,653
Investments (Notes 4 and 18)	1,926,867	1,895,100
Accounts Receivable (Note 5)	30	17
Other:		
Advances and Prepayments	161	-
Total Intragovernmental Assets	<u>1,969,821</u>	<u>1,942,770</u>
Accounts and Interest Receivable, Net (Notes 6 and 18)	35,010	1,235
General Property, Plant & Equipment, Net (Note 7)	2,978	2,682
TOTAL ASSETS	<u>\$2,007,809</u>	<u>\$1,946,687</u>
LIABILITIES (Note 8)		
Intragovernmental Liabilities:		
Accounts Payable (Note 18)	\$259	\$220
Other:		
Accrued Payroll and Benefits	218	570
Unfunded Payroll Costs	919	894
Other Liabilities (Note 9)	714	243
Total Intragovernmental Liabilities	<u>2,110</u>	<u>1,927</u>
Public Liabilities:		
Accounts Payable (Note 18)	12,054	8,023
Federal Employees' Compensation Act Liability (Note 18)	4,440	3,460
Other:		
Accrued Payroll and Benefits (Note 18)	1,194	2,694
Unfunded Payroll Costs	4,340	4,307
Contingent Liabilities (Note 10)	68,500	25,049
Other Liabilities (Note 9)	575	8,371
Total Public Liabilities	<u>91,103</u>	<u>51,904</u>
TOTAL LIABILITIES	<u>93,213</u>	<u>53,831</u>
Commitments and Contingencies (Notes 10, 11, and 17)		
Net Position		
Unexpended Appropriations	36,299	36,038
Cumulative Results of Operations	1,878,297	1,856,818
Total Net Position (Note 18)	<u>1,914,596</u>	<u>1,892,856</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$2,007,809</u>	<u>\$1,946,687</u>

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

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

For the years ended September 30, 2003 and 2002
(dollars in thousands)

	2003	2002
Environmental Restoration		
Gross Cost	\$191,354	\$194,401
Less: Earned Revenue	182	406
Net Cost (Note 18)	<u>191,172</u>	<u>193,995</u>
Environmental Protection		
Gross Cost	154,454	55,962
Less: Earned Revenue	1,084	947
Net Cost	<u>153,370</u>	<u>55,015</u>
United Mine Workers Combined Benefit Fund		
Gross Cost	48,249	77,984
Less: Earned Revenue	-	-
Net Cost (Note 18)	<u>48,249</u>	<u>77,984</u>
Totals		
Gross Costs	394,057	328,347
Less: Earned Revenue	1,266	1,353
Net Cost (Note 12)	<u>\$392,791</u>	<u>\$326,994</u>

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

**Department of the Interior
Office of Surface Mining
Consolidated Statements of Changes in Net Position**

For the years ended September 30, 2003 and 2002
(dollars in thousands)

	2003	2002
UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$36,038	\$40,319
Budgetary Financing Sources		
Appropriations Received, General Funds	105,092	102,800
Appropriations-Used	(103,609)	(105,471)
Other Adjustments (rescissions, etc.)	(1,222)	(1,610)
Total Budgetary Financing Sources	261	(4,281)
Ending Balance - Unexpended Appropriations	<u>\$36,299</u>	<u>\$36,038</u>
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$1,856,818	\$1,752,258
Budgetary Financing Sources		
Appropriations-Used	103,609	105,471
Transfers Out without Reimbursement	(271)	-
Non-Exchange Revenue:		
Abandoned Mine Land Fees (Note 18)	282,411	285,580
Forfeitures of Cash	112	4
Other Non-Exchange Revenue (Note 18)	23,712	36,251
Other Financing Sources		
Imputed Financing from Costs Absorbed by Others	4,784	4,285
Transfers Out without Reimbursement	(87)	(37)
Total Financing Sources	414,270	431,554
Net Cost of Operations	(392,791)	(326,994)
Ending Balance - Cumulative Results of Operations	<u>\$1,878,297</u>	<u>\$1,856,818</u>

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

**Department of the Interior
Office of Surface Mining
Combined Statements of Budgetary Resources**

For the years ended September 30, 2003 and 2002
(dollars in thousands)

	2003	2002
Budgetary Resources:		
Budget Authority -		
Appropriations Received (Note 13)	\$387,031	\$419,971
Unobligated Balance -		
Beginning of Fiscal Year	53,524	54,265
Spending Authority From Offsetting Collections:		
Earned		
Collected	1,173	24,620
Receivable From Federal Sources	36	14
Change in Unfilled Customer Orders		
Without Advance From Federal Sources	9	(227)
Recoveries of Prior Year Obligations	26,937	34,711
Temporarily Not Available Pursuant to Public Law	-	(23,502)
Permanently Not Available	(2,690)	(1,628)
Total Budgetary Resources	\$466,020	\$508,224
Status of Budgetary Resources:		
Obligations Incurred (Note 14):		
Direct	\$421,557	\$453,540
Reimbursable	1,000	1,160
Total Obligations Incurred	422,557	454,700
Unobligated Balance		
Apportioned	39,372	50,337
Unobligated Balance not Available	4,091	3,187
Total Status of Budgetary Resources	\$466,020	\$508,224
Relationship of Obligations to Outlays:		
Obligations Incurred (Note 14)	422,557	454,700
Obligated Balance, Net, Beginning of Fiscal Year	353,962	352,355
Obligated Balance, Net, End of Fiscal Year:		
Accounts Receivable	53	17
Unfilled Customer Orders From Federal Sources	263	254
Undelivered Orders	(351,793)	(342,733)
Accounts Payable	(13,725)	(11,500)
Less: Spending Authority Adjustments	(26,982)	(34,498)
Outlays:		
Disbursements	384,335	418,595
Collections	(1,173)	(24,620)
Subtotal	383,162	393,975
Less: Offsetting Receipts (Note 15)	(23,842)	(43,556)
Net Outlays	\$359,320	\$350,419

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

**Department of the Interior
Office of Surface Mining
Consolidated Statements of Financing**

For the years ended September 30, 2003 and 2002
(dollars in thousands)

	2003	2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations Incurred	\$422,557	\$454,700
Less: Spending Authority From Offsetting Collections/Recoveries	(28,155)	(59,118)
Obligations Net of Offsetting Collections and Recoveries	394,402	395,582
Less: Offsetting Receipts (Note 15)	(23,842)	(43,556)
Net Obligations	370,560	352,026
Other Resources:		
Transfers In/Out Without Reimbursement	(87)	(37)
Imputed Financing From Costs Absorbed by Others	4,784	4,285
Net Other Resources Used to Finance Activities	4,697	4,248
Total Resources Used to Finance Activities	375,257	356,274
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	(9,212)	(4,253)
Resources That Fund Expenses Recognized in Prior Periods	(7,343)	(68,911)
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations:		
Offsetting Receipts and Other	23,849	43,546
Resources That Finance the Acquisition of Assets	(885)	(637)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	6,409	(30,255)
Total Resources Used to Finance the Net Cost of Operations	381,666	326,019
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 in Annual Leave Liability	34	311
Other	10,755	215
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	10,789	526
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	590	531
Allocation Transfer Account Reconciling Item (Note 16)	(254)	(82)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	336	449
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	11,125	975
Net Cost of Operations	\$392,791	\$326,994

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

OFFICE OF SURFACE MINING

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 2003 AND 2002

Note 1. Summary of Significant Accounting Policies:

A. Reporting Entity

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

During 2003, the OSM Director has been discussing Abandoned Mine Land fee reauthorization with members of Congress, coal industry representatives, state reclamation officials and environmentalists. In the upcoming year OSM will be assisting Congress in identifying issues, analyzing alternatives and drafting reauthorization legislation.

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

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

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

1. General Funds: These funds consist of expenditure accounts used to record financial transactions arising from Congressional appropriations as well as receipt accounts. The principal general fund expenditure and receipt accounts maintained are:
 - a. Regulation and Technology - These funds consist of expenditure accounts used to record financial transactions arising from congressional appropriations to spend general revenue. These funds support the financing of state regulatory grants, oversight of state regulatory programs, research and development facilitating the transfer of reclamation expertise to states, and the partial financing of all OSM operations and maintenance costs. Funding is appropriated on an annual basis.
 - b. Bond Forfeitures – This fund consists of receipt and expenditure accounts used to collect bonds forfeited by coal operators. Funds from these bonds are used to reclaim the mine site.
2. Special Funds: These funds consist of special fund receipt, expenditure, and investment accounts and include the following:
 - a. Abandoned Mine Land (AML) Funds - These funds were established by SMCRA for the deposit of coal reclamation fees, related late payment interest, and administrative charges recovered in pursuing collections. Available reclamation fees are used solely to finance the AML reclamation program. However, before AML funds can be used, a Congressional appropriation is necessary to authorize yearly spending limits. Available AML special fund balances, in excess of current cash requirements, are regularly invested in non-marketable federal securities as authorized under Public Law 101-508.
 - b. Civil Penalties - This fund consists of receipt and expenditure accounts used to collect penalties levied against permittees who violate any permit condition or provision of Title 30 U.S.C; 1268. Funds from these assessments are used to reclaim lands adversely affected by coal mining practices on or after August 3, 1977.
3. Deposit Funds: These funds are maintained to account for receipts awaiting proper classification or receipts held in escrow until ownership is established, at which time proper distribution can be made. Additionally, OSM collects miscellaneous interest, judicial service and administrative fees which are credited to Treasury's general fund. In the billing and collection of these funds, OSM is merely acting as an agent for the Treasury.

Government Performance and Results Act (GPRA) Program Activities - Beginning in Fiscal Year 1998, OSM is responsible for reporting costs by GPRA program activity. OSM's GPRA program activities are:

1. Environmental Restoration - This program is responsible for the reclamation of abandoned mine land affected by mining that took place before the Surface Mining Law was passed in 1977. It includes grants to States and Indian Tribes, emergency projects, the Appalachian Clean Streams Initiatives, financial management of Abandoned Mine Land fees and investments, as well as funding of related OSM activities.
2. Environmental Protection - This program is responsible for ensuring that the Surface Mining Law's goals are achieved, primarily through the States and Indian Tribes. It includes OSM rule making, grants to States and Indian Tribes to conduct and develop their regulatory programs, OSM regulatory operations in non-primacy states, and OSM state program evaluations and oversight.
3. United Mine Workers of America Combined Benefit Fund Transfer – This program is for the transfer of funds to the United Mine Workers of America Combined Benefit Fund. This is an annual transfer required by the Energy Policy Act of 1992. The transfer is used to pay for health care benefits for certain coal miners and their beneficiaries.

B. Basis of Accounting and Presentation

These financial statements have been prepared to report the financial position, the net cost, the changes in net position, the budgetary resources, and the reconciliation of net cost of budgetary resources, as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These financial statements have been prepared from the books and records of OSM in accordance with accounting principles generally accepted in the United States of America using guidance issued by the Federal Accounting Standards Advisory Board (FASAB), the Office of Management and Budget (OMB) and OSM's accounting policies, which are summarized in this note. In certain instances, prior year amounts have been reclassified to conform to current year presentation. These financial statements present proprietary and budgetary information while other financial reports also prepared by OSM pursuant to OMB directives are used to monitor and control OSM's use of budgetary resources.

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

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

Intragovernmental assets and liabilities arise from transactions with other Federal agencies. Significant interfund balances and transactions have been eliminated in consolidation.

The accounting principles and standards applied in preparing the financial statements and described in this note are in accordance with the following hierarchy of accounting principles:

1. FASAB Statements entitled Statements of Federal Financial Accounting Standards (SFFAS). These statements reflect the accounting principles, standards, and requirements recommended by the FASAB and approved by the General Accounting Office (GAO), OMB and Treasury. Additionally, FASAB Interpretations provide further clarification to the approved standards.
2. Form and content requirements for financial statements, as presented in OMB Bulletin No. 01-09 (Form and Content of Agency Financial Statements). Note that the provisions of published SFFAS and interpretations take precedence over OMB Form and Content Guidance.
3. Other Authoritative Guidance. If questions arise regarding issues that are not addressed by SFFAS or OMB Form and Content guidance, the agency looks to authoritative guidance issued by other standard setting bodies, such as the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).
4. The accounting principles and standards contained in departmental and bureau accounting policy and procedures manuals, and/or related guidance.
5. Statements of Federal Financial Accounting Concepts (SFFAC). These concepts are not authoritative, per se, and do not have required implementation dates. However, they do contain very useful guidance regarding the completeness of the reporting entity and the presentation of financial information.

**Office of Surface Mining
Notes to Financial Statements
September 30, 2003 and 2002 (continued)**

C. Revenues and Financing Sources

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

The AML program is funded by a reclamation fee assessed on coal mine operators. The fee is based on the type and volume of coal produced for sale, transfer, or use. As appropriated by Congress, monies received and deposited in this special fund are used to reclaim lands adversely affected by past mining. Fees collected, but not yet appropriated, are held for future appropriations. Payments to the United Mine Workers of America Combined Benefit Fund are funded through earnings on investments of undisbursed AML fund balances. See Notes 1G and 4 for additional information. In accordance with Federal financial accounting standards the AML fees are recognized when the fees are specifically identifiable and legally enforceable. This occurs thirty days after the close of a calendar quarter.

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

D. Distribution of AML Appropriation for Reclamation Grants

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

E. Grant Expenditures

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

F. Fund Balance with Treasury

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

G. Investments

OSM invests excess cash from AML fee collections in Treasury certificates. Note 4 provides additional information concerning investments. Some of these investment earnings are transferred to the United Mine Workers of America Combined Benefit Fund.

H. Allowance for Doubtful Accounts

OSM uses two different methodologies to recognize bad debts arising from uncollectible accounts receivable, the net of the allowance method and the specific analysis method. The net of the allowance method is used for special and civil penalty funds accounts receivable. Under this method, an allowance for doubtful accounts is calculated based upon OSM's past experience in successfully collecting delinquent accounts receivable by aging category. However, the specific analysis method was used for one account because it represented 36% of the outstanding accounts receivable. For all other types, the allowance is based on an analysis of each account receivable.

I. Personnel Compensation and Benefits

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

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

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

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

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

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

J. Income Taxes

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

K. Use of Estimates

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

Note 2. Asset Analysis:

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

(dollars in thousands)	Unrestricted Entity 2003	Unrestricted Entity 2002
ASSETS		
Intragovernmental Assets:		
Fund Balance with Treasury	\$42,763	\$47,653
Investments, Net	1,926,867	1,895,100
Accounts and Interest Receivable	30	17
Other		
Advances and Prepayments	161	-
Total Intragovernmental Assets	1,969,821	1,942,770
Accounts and Interest Receivable, Net	35,010	1,235
General Property, Plant & Equipment, Net	2,978	2,682
TOTAL ASSETS	\$2,007,809	\$1,946,687

**Office of Surface Mining
Notes to Financial Statements
September 30, 2003 and 2002 (continued)**

Note 3. Fund Balance with Treasury:

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

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

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

Fund Balances by Fund Type

(dollars in thousands)

	2003	2002
General Funds	\$41,213	\$41,399
Special Funds	823	5,550
Other Fund Types	727	704
Total Fund Balance with Treasury by Fund Type	<u>\$42,763</u>	<u>\$47,653</u>

Status of Fund Balance with Treasury

	2003	2002
Unobligated		
Available	\$1,789	\$1,815
Unavailable	4,818	3,891
Obligated Not Yet Disbursed	36,156	41,947
Total Status of Fund Balance with Treasury	<u>\$42,763</u>	<u>\$47,653</u>

Note 4. Investments, Non-Marketable:

Effective October 1, 1991, OSM was given authority to invest the balance of the AML Fund in non-marketable federal securities under Public Law 101-508. The Bureau of Public Debt is the sole issuer of authorized non-marketable Federal securities, which are purchased by OSM directly from the Treasury. OSM may invest in bills, notes, bonds, and one-day certificates. There are no restrictions on federal agencies as to the use or convertibility of Treasury non-marketable securities. During FY 2003 and 2002 OSM was fully invested in one-day certificates.

(dollars in thousands)

Security Type	Cost	Market Value Disclosure
2003		
Non-Marketable:		
Market Based	\$1,926,867	\$1,926,867
Accrued Interest	-	-
Totals	<u>\$1,926,867</u>	<u>\$1,926,867</u>
2002		
Non-Marketable:		
Market Based	\$1,895,000	\$1,895,000
Accrued Interest	100	100
Totals	<u>\$1,895,100</u>	<u>\$1,895,100</u>

Note 5. Intragovernmental Accounts Receivable:

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

(dollars in thousands)	2003	2002
Unbilled Intragovernmental Accounts Receivable	<u>\$30</u>	<u>\$17</u>

Note 6. Accounts and Interest Receivable, Net:

Accounts receivable with the public are recorded net of the allowance for doubtful accounts. These receivables represent uncollected Abandoned Mine Land, civil penalty and audit fees. Additionally, OSM has an accrued accounts receivable from the United Mine Worker's Combined Benefit Fund in the amount of \$33.7 million as of September 30, 2003. This receivable can be classified as an adjustment to OSM's annual payment to the UMWA-CBF. This adjustment resulted from the Social Security Administration's reassignment of certain beneficiaries and an over payment of estimated AML Fund interest earnings due to declining interest rates during FY 2003.

An aging of OSM's accounts receivable with the public is displayed below for both fiscal years. An analysis of OSM's allowance for doubtful accounts is also provided below.

(dollars in thousands)	2003	2002
Accounts Receivable from the Public		
Current	\$1,564	\$1,560
1 - 180 Days Past Due	387	421
181 - 365 Days Past Due	611	218
Over 1 Year Past Due	460	838
Total Billed Accounts Receivable - Public	<u>3,022</u>	<u>3,037</u>
Unbilled Accounts Receivable	<u>33,723</u>	-
Total Accounts Receivable - Public	<u>36,745</u>	<u>3,037</u>
Allowance for Doubtful Accounts	<u>(1,735)</u>	<u>(1,802)</u>
Total Accounts Receivable - Public, Net	<u>\$35,010</u>	<u>\$1,235</u>
Change in Allowance for Doubtful Accounts		
Allowance for Doubtful Accounts, beginning	\$1,802	\$1,372
Additions	1,558	2,762
Deletions	<u>(1,625)</u>	<u>(2,332)</u>
Allowance for Doubtful Accounts	<u>\$1,735</u>	<u>\$1,802</u>

**Office of Surface Mining
Notes to Financial Statements
September 30, 2003 and 2002 (continued)**

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

OSM does not own any real estate or buildings. All property and equipment are valued at historical cost. Property and equipment are capitalized whenever the initial acquisition cost is \$15 thousand or greater and the estimated useful life is two years or longer. Leasehold improvements and computer software are not capitalized unless the acquisition cost is \$100 thousand or more. All property and equipment is depreciated using the straight-line method and the asset's useful life is determined using OMB guidance.

2003 (dollars in thousands)	Service Life in years	Acquisition Value	Accumulated Depreciation	Net Book Value
Equipment				
ADP	15	\$1,520	(\$1,031)	\$489
Office	11-20	924	(277)	647
Vehicles	6-10	2,993	(1,702)	1,291
Leasehold Improvements	2-10	599	(48)	551
Totals		<u>\$6,036</u>	<u>(\$3,058)</u>	<u>\$2,978</u>
2002 (dollars in thousands)	Service Life in Years	Acquisition Value	Accumulated Depreciation	Net Book Value
Equipment				
ADP	15	\$1,930	(\$1,402)	\$528
Office	11-20	974	(261)	713
Vehicles	6-10	2,987	(1,546)	1,441
Leasehold Improvements	2-10	-	-	-
Totals		<u>\$5,891</u>	<u>(\$3,209)</u>	<u>\$2,682</u>

Note 8. Liabilities:

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

2003 (dollars in thousands)	Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
	Current	Non-Current	Current	Non-Current	
Intragovernmental Liabilities:					
Accounts Payable	\$259	\$0	\$0	\$0	\$259
Other					
Accrued Payroll and Benefits	218	-	-	-	218
Unfunded Payroll Costs	-	-	300	619	919
Other Liabilities	152	-	83	479	714
Total Intragovernmental Liabilities	629	-	383	1,098	2,110
Public Liabilities:					
Accounts Payable	12,054	-	-	-	12,054
Federal Employees' Compensation Act Liability	-	-	-	4,440	4,440
Other					
Accrued Payroll and Benefits	1,194	-	-	-	1,194
Unfunded Payroll Costs	-	-	-	4,340	4,340
Contingent Liabilities	-	-	68,500	-	68,500
Other Liabilities	-	-	575	-	575
Total Public Liabilities	13,248	-	69,075	8,780	91,103
Total Liabilities	\$13,877	\$0	\$69,458	\$9,878	\$93,213

2002 (dollars in thousands)	Covered by Budgetary Resources		Not Covered by Budgetary Resources		Total
	Current	Non-Current	Current	Non-Current	
Intragovernmental Liabilities:					
Accounts Payable	\$220	\$0	\$0	\$0	\$220
Other					
Accrued Payroll and Benefits	570	-	-	-	570
Unfunded Payroll Costs	-	-	290	604	894
Other Liabilities	243	-	-	-	243
Total Intragovernmental Liabilities	1,033	-	290	604	1,927
Public Liabilities:					
Accounts Payable	8,023	-	-	-	8,023
Federal Employees' Compensation Act Liability	-	-	-	3,460	3,460
Other					
Accrued Payroll and Benefits	2,694	-	-	-	2,694
Unfunded Payroll Costs	-	-	-	4,307	4,307
Contingent Liabilities	-	-	25,049	-	25,049
Other Liabilities	-	-	8,371	-	8,371
Total Public Liabilities	10,717	-	33,420	7,767	51,904
Total Liabilities	\$11,750	\$0	\$33,710	\$8,371	\$53,831

**Office of Surface Mining
Notes to Financial Statements
September 30, 2003 and 2002 (continued)**

Note 9. Other Liabilities:

Other liabilities consist of advances from others for reimbursable agreements, miscellaneous liabilities associated with non-entity receivables that will be transferred to Treasury upon collection and amounts recorded in deposit and suspense funds. Amounts recorded in deposit and suspense funds include; permit and civil penalty escrows, bonds, misapplied deposits pending correction and excess AML fee payments due to be refunded or remitted to Treasury.

Additionally, OSM is required by law to annually transfer a portion of the interest earned from the Abandoned Mine Land Special Fund to the United Mine Workers Combined Benefit Fund to provide health benefits for certain eligible retired coal miners and their dependents. Payments are made in advance based on the number of beneficiaries and an estimate of their benefit costs. Under current practice, the estimate is then adjusted to actual costs as health benefits are paid in subsequent years.

(dollars in thousands)	2003	2002
Intragovernmental Other Liabilities:		
Advances from Others	\$0	\$243
Liability for Deposits Funds and Suspense	151	-
Other Unfunded Liabilities	563	-
Total Intragovernmental Other Liabilities	<u>\$714</u>	<u>\$243</u>
Public, Other Liabilities:		
Liability for Deposits Funds and Suspense	\$575	\$462
Due and Payable to the UMWA-CBF	-	7,909
Total Public, Other Liabilities	<u>\$575</u>	<u>\$8,371</u>

Note 10. Contingent and Environmental Liabilities:

Contingent Liabilities:

There have been claims filed against OSM with adjudications pending. As of September 30, 2003 a liability of \$68,500 thousand has been accrued in the financial statements for cases in which payment has been deemed probable and for which the amount of potential liability is estimable. The U.S. Treasury's Judgment Fund would likely bear most of the costs incurred to pay any judgments or settlements and the resultant outcomes should not materially affect OSM's future financial condition. The related liability at September 30, 2002 was \$25,049 thousand.

In addition to the amounts disclosed above, OSM has adjudications pending where the likelihood of an unfavorable outcome is reasonably possible. An estimate of potential loss for pending adjudications in this category for FY 2003 ranges from \$100 to \$10,000 thousand and the FY 2002 amounts range from \$560 to \$22,645 thousand. However, no amounts have been accrued in the financial records for claims where the probability or amount of judgment is uncertain.

Environmental Liabilities:

Although OSM's mission includes the administration of programs designed to protect society from the effects of coal mining operations, OSM has no liability for future environmental cleanup. OSM does not own land or contribute to environmental contamination.

Note 11. Commitments and Contingencies:

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

Note 12. Net Cost by Segment:

OSM's net cost is presented below by responsibility segment and program activity with intragovernmental and public disclosures. The Office of Surface Mining Operations segment accounts for those net costs required to operate OSM and its Federal programs that are not transferred to states and tribes in the form of grants. The FY 2002 negative net cost in the Operations segment and Environmental Protection program is attributable to a large downward re-estimate of a contingent legal liability, see Note 10 for additional information. Intragovernmental gross costs approximate intragovernmental revenues with the addition of a pro rata share of imputed costs.

2003 Supporting Schedule by Responsibility Segment

(dollars in thousands)	Office of Surface Mining Operations	Grants to States and Tribes	Authorized Special Payments	2003 Total
Environmental Restoration				
Gross Costs with the Public	\$38,429	\$152,828	\$0	\$191,257
Less: Earned Revenue from the Public	86	-	-	86
Net Cost with the Public	38,343	152,828	-	191,171
Intragovernmental Gross Costs	97	-	-	97
Less: Intragovernmental Earned Revenue	96	-	-	96
Intragovernmental Net Costs	1	-	-	1
Total Net Costs	38,344	152,828	-	191,172
Environmental Protection				
Gross Costs with the Public	95,978	57,489	-	153,467
Less: Earned Revenue from the Public	117	-	-	117
Net Cost with the Public	95,861	57,489	-	153,350
Intragovernmental Gross Costs	987	-	-	987
Less: Intragovernmental Earned Revenue	967	-	-	967
Intragovernmental Net Costs	20	-	-	20
Total Net Costs	95,881	57,489	-	153,370
UMWA CBF Transfer				
Gross Costs with the Public	-	-	48,249	48,249
Less: Earned Revenue from the Public	-	-	-	-
Net Cost with the Public	-	-	48,249	48,249
Intragovernmental Gross Costs	-	-	-	-
Less: Intragovernmental Earned Revenue	-	-	-	-
Intragovernmental Net Costs	-	-	-	-
Total Net Costs	-	-	48,249	48,249
Total				
Gross Costs with the Public	134,407	210,317	48,249	392,973
Less: Earned Revenue from the Public	203	-	-	203
Net Cost with the Public	134,204	210,317	48,249	392,770
Intragovernmental Gross Costs	1,084	-	-	1,084
Less: Intragovernmental Earned Revenue	1,063	-	-	1,063
Intragovernmental Net Costs	21	-	-	21
Total Net Costs	\$134,225	\$210,317	\$48,249	\$392,791

**Office of Surface Mining
Notes to Financial Statements
September 30, 2003 and 2002 (continued)**

2002 Supporting Schedule by Responsibility Segment

(dollars in thousands)	Office of Surface Mining Operations	Grants to States and Tribes	Authorized Special Payments	2002 Total
Environmental Restoration				
Gross Costs with the Public	\$37,477	\$156,574	\$0	\$194,051
Less: Earned Revenue from the Public	58	-	-	58
Net Cost with the Public	37,419	156,574	-	193,993
Intragovernmental Gross Costs	350	-	-	350
Less: Intragovernmental Earned Revenue	348	-	-	348
Intragovernmental Net Costs	2	-	-	2
Total Net Costs	37,421	156,574	-	193,995
Environmental Protection				
Gross Costs with the Public	(6,398)	61,402	-	55,004
Less: Earned Revenue from the Public	37	-	-	37
Net Cost with the Public	(6,435)	61,402	-	54,967
Intragovernmental Gross Costs	958	-	-	958
Less: Intragovernmental Earned Revenue	910	-	-	910
Intragovernmental Net Costs	48	-	-	48
Total Net Costs	(6,387)	61,402	-	55,015
UMWA CBF Transfer				
Gross Costs with the Public	-	-	77,984	77,984
Less: Earned Revenue from the Public	-	-	-	-
Net Cost with the Public	-	-	77,984	77,984
Intragovernmental Gross Costs	-	-	-	-
Less: Intragovernmental Earned Revenue	-	-	-	-
Intragovernmental Net Costs	-	-	-	-
Total Net Costs	-	-	77,984	77,984
Total				
Gross Costs with the Public	31,079	217,976	77,984	327,039
Less: Earned Revenue from the Public	95	-	-	95
Net Cost with the Public	30,984	217,976	77,984	326,944
Intragovernmental Gross Costs	1,308	-	-	1,308
Less: Intragovernmental Earned Revenue	1,258	-	-	1,258
Intragovernmental Net Costs	50	-	-	50
Total Net Costs	\$31,034	\$217,976	\$77,984	\$326,994

Note 13. Appropriations Received:

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

Note 14. Obligations Incurred:

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

Note 15. Offsetting Receipts:

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

Note 16. Allocation Transfer Account, Reconciling Item:

In previous years OSM has transferred Abandoned Mine Land budget authority to the Department of Agriculture's Natural Resource Conservation Service in accordance with SMRCA and Congressional appropriations. These allocation transfers are for the purpose of providing for the control and prevention of erosion and sediment damages from unreclaimed mine lands, and to promote the conservation and development of soil and water resources on those lands.

Budget authority that is transferred to another agency or bureau will create a reconciling item on the Statement of Financing because OSM reports the related budget activity on the Statements of Budgetary Resources while the Natural Resource Conservation Service reports its results of operations on its Statements of Net Cost. This presentation is required by authoritative accounting guidance.

Note 17. Operating Leases:

OSM's facilities are rented from the General Services Administration (GSA), which charges rent that is intended to approximate commercial rental rates. For Federally-owned property, OSM generally does not execute an agreement with GSA nor is there a formal expiration date. However, OSM is normally required to give 120 to 180 days notice to vacate the property and the amount of these leases remains fairly constant from year to year. These leases are included in the estimated future lease payments for FY 2004 through FY 2008 and beyond below. For non-Federally owned property, an occupancy agreement is executed, and again OSM may normally cancel these agreements with 120 days notice. The estimated rent payments to GSA for both Federally-owned and publicly-owned buildings are presented in the table that follows. OSM rental expense for 2003 and 2002 was \$3,422 and \$2,905 thousand, respectively.

(dollars in thousands)

Fiscal Year	GSA Real Property
2004	\$2,692
2005	1,469
2006	1,365
2007	1,388
2008	1,412
Thereafter	2,418
Total Future Lease Payments	<u>\$10,744</u>

**Office of Surface Mining
Notes to Financial Statements
September 30, 2003 and 2002 (continued)**

Note 18. Dedicated Collections:

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

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

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

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

AML program expenses approximate the net cost for the Environmental Restoration GPRA program activity with the addition (+/-) of a pro rata share of allocated costs.

The following table provides condensed information on the AML Fund:

(dollars in thousands)	2003	2002
ASSETS		
Fund Balance with Treasury	\$543	\$5,318
Investments, Net	1,926,867	1,895,100
Amounts Due from UMWA-CBF	33,700	-
Accounts Receivable, Net	1,265	1,214
Other Assets	40	-
TOTAL ASSETS	\$1,962,415	\$1,901,632
LIABILITIES		
Accounts Payable	\$9,304	\$6,644
Accrued Payroll and Benefits	477	925
Amounts Due and Payable to the UMWA-CBF	-	7,909
TOTAL LIABILITIES	9,781	15,478
Total Net Position	1,952,634	1,886,154
TOTAL LIABILITIES AND NET POSITION	\$1,962,415	\$1,901,632
CHANGE IN NET POSITION		
Net Position, Beginning of Fiscal Year	\$1,886,154	\$1,837,412
Change in Net Position:		
Non-exchange Revenue		
AML Fee Revenue	282,411	285,580
Investment Interest and Other	23,720	36,330
Exchange Revenue - Services Provided and Other	103	356
Program Expenses	(191,505)	(195,540)
UMWA-CBF Expenses	(48,249)	(77,984)
Net Position, End of Fiscal Year	\$1,952,634	\$1,886,154

Department of the Interior
Office of Surface Mining
Supplementary Statement of Budgetary Resources by Major Budget Account

For the year ended September 30, 2003
(dollars in thousands)

	Abandoned Mine Lands	Regulation and Technology	Total
Budgetary Resources:			
Budget Authority -			
Appropriations Received	\$281,843	\$105,188	\$387,031
Unobligated Balance -			
Beginning of Fiscal Year	48,793	4,731	53,524
Spending Authority From Offsetting Collections:			
Earned			
Collected	111	1,062	1,173
Receivable From Federal Sources	(9)	45	36
Change in Unfilled Customer Orders			
Without Advance From Federal Sources	(40)	49	9
Recoveries of Prior Year Obligations	24,855	2,082	26,937
Permanently Not Available	(1,467)	(1,223)	(2,690)
Total Budgetary Resources	\$354,086	\$111,934	\$466,020
Status of Budgetary Resources:			
Obligations Incurred:			
Direct	\$316,553	\$105,004	\$421,557
Reimbursable	(51)	1,051	1,000
Total Obligations Incurred	316,502	106,055	422,557
Unobligated Balance			
Apportioned	37,584	1,788	39,372
Unobligated Balance not Available	-	4,091	4,091
Total Status of Budgetary Resources	\$354,086	\$111,934	\$466,020
Relationship of Obligations to Outlays:			
Obligations Incurred	\$316,502	\$106,055	\$422,557
Obligated Balance, Net, Beginning of Fiscal Year	317,333	36,629	353,962
Obligated Balance, Net, End of Fiscal Year:			
Accounts Receivable	-	53	53
Unfilled Customer Orders From Federal Sources	20	243	263
Undelivered Orders	(319,829)	(31,964)	(351,793)
Accounts Payable	(9,781)	(3,944)	(13,725)
Less: Spending Authority Adjustments	(24,806)	(2,176)	(26,982)
Outlays:			
Disbursements	279,440	104,895	384,335
Collections	(111)	(1,062)	(1,173)
Subtotal	279,329	103,833	383,162
Less: Offsetting Receipts	(23,842)	-	(23,842)
Net Outlays	\$255,487	\$103,833	\$359,320

Unaudited - see accompanying Independent Auditors' Report.

Department of the Interior
Office of Surface Mining
Supplementary Statement of Budgetary Resources by Major Budget Account

For the year ended September 30, 2002
(dollars in thousands)

	Abandoned Mine Lands	Regulation and Technology	Total
Budgetary Resources:			
Budget Authority -			
Appropriations Received	\$317,136	\$102,835	\$419,971
Unobligated Balance -			
Beginning of Fiscal Year	49,005	5,260	54,265
Spending Authority From Offsetting Collections:			
Earned			
Collected	23,678	942	24,620
Receivable From Federal Sources	6	8	14
Change in Unfilled Customer Orders			
Without Advance From Federal Sources	(169)	(58)	(227)
Recoveries of Prior Year Obligations	32,451	2,260	34,711
Temporarily Not Available Pursuant to Public Law	(23,502)	-	(23,502)
Permanently Not Available	(18)	(1,610)	(1,628)
Total Budgetary Resources	\$398,587	\$109,637	\$508,224
Status of Budgetary Resources:			
Obligations Incurred:			
Direct	\$349,662	\$103,878	\$453,540
Reimbursable	132	1,028	1,160
Total Obligations Incurred	349,794	104,906	454,700
Unobligated Balance			
Apportioned	48,793	1,544	50,337
Unobligated Balance not Available	-	3,187	3,187
Total Status of Budgetary Resources	\$398,587	\$109,637	\$508,224
Relationship of Obligations to Outlays:			
Obligations Incurred	\$349,794	\$104,906	\$454,700
Obligated Balance, Net, Beginning of Fiscal Year	310,587	41,768	352,355
Obligated Balance, Net, End of Fiscal Year:			
Accounts Receivable	9	8	17
Unfilled Customer Orders From Federal Sources	60	194	254
Undelivered Orders	(309,840)	(32,893)	(342,733)
Accounts Payable	(7,562)	(3,938)	(11,500)
Less: Spending Authority Adjustments	(32,288)	(2,210)	(34,498)
Outlays:			
Disbursements	310,760	107,835	418,595
Collections	(23,678)	(942)	(24,620)
Subtotal	287,082	106,893	393,975
Less: Offsetting Receipts	(43,556)	-	(43,556)
Net Outlays	\$243,526	\$106,893	\$350,419

Unaudited - see accompanying Independent Auditors' Report.

KPMG LLP AUDIT OPINION



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

December 9, 2003

Memorandum

To: Director, Office of Surface Mining Reclamation and Enforcement

From: Roger La Rouché *Roger LaRouche*
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Office of Surface Mining Reclamation and Enforcement's Financial Statements for Fiscal Years 2003 and 2002 (Report No. C-IN-OSM-0079-2003)

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

In its Independent Auditor's Report dated October 31, 2003, (Attachment 1) KPMG issued an unqualified opinion on OSM's financial statements. KPMG identified two reportable conditions related to internal controls and financial operations: (1) security and internal control over information technology systems and (2) internal control over charge cards. With regard to compliance with laws and regulations, KPMG found OSM to be noncompliant with a portion of the Federal Financial Management Improvement Act. Specifically, OSM's financial management systems did not substantially comply with Federal financial management systems requirements.

KPMG is responsible for the auditors' report and for the conclusions expressed in the report. We do not express an opinion on the Office of Surface Mining Reclamation and Enforcement's financial statements, conclusions on the effectiveness of internal control, conclusions on whether the Office of Surface Mining Reclamation and Enforcement's financial management systems substantially complied with FFMIA; or conclusions on compliance with laws and regulations.

In the November 5, 2003 response (Attachment 2), OSM concurred with the report's findings and recommendations and indicated corrective actions have been implemented for Recommendations A.1 and C.1. OSM indicated that corrective action for Recommendation B.1

will be implemented in fiscal year 2004. Based on OSM's response, we consider Recommendations A.1 and C.1 resolved and implemented and Recommendation B.1 resolved but not implemented. Recommendation B.1 will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

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

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

Attachments (2)



707 Seventeenth Street
Suite 2700
Denver, CO 80202

Independent Auditors' Report

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

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

Summary

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

Our consideration of internal control over financial reporting identified the following reportable conditions. However, these reportable conditions are not believed to be material weaknesses.

- A. Security and Internal Control Over Information Technology Systems
- B. Internal Control Over Charge Cards

The results of our tests of compliance with laws and regulations, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The results of our tests of FFMIA disclosed instances where the OSM's financial management systems did not substantially comply with Federal financial management systems requirements.

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



KPMG LLP, KPMG LLP a U.S. limited liability partnership, is
a member of KPMG International, a Swiss association.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the Office of Surface Mining Reclamation and Enforcement (OSM) as of September 30, 2003 and 2002, and the related consolidated statements of net costs, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended.

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

The information in the Management Discussion and Analysis, at pages 6 through 70, and Required Supplementary Information, at pages 89 through 90, is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

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 the OSM's ability to initiate, record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

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

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

A. Security and Internal Control Over Information Technology Systems

Security and general controls over the OSM's financial management systems have not been fully implemented. Improvement is needed in the areas described below, as required by OMB Circular A-130, *Management of Federal Information Resources*. The conditions below could affect the OSM's ability to prevent or detect unauthorized changes to subsidiary financial information, control electronic access to sensitive information, and protect its information resources.

Security Programs

Security programs, including security policies and a related implementation plan, support systems, and major applications are the foundation of an entity's security control structure and a reflection of senior management's commitment to addressing security risks. As outlined in OMB Circular A-130, an effective security program includes a risk assessment process, a certification process, and rules of behavior that define and guide the use of financial systems. The OSM has not finalized security

policies for one of its financial support applications. In addition, employee background investigations, which are integral to data and systems security, are not being performed consistently and/or in a timely manner.

Access Controls

Access controls should provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. The objectives of logical access are to ensure that: (1) only authorized users have access to data and resources; (2) users have the minimum access necessary to perform their job functions; (3) access to very sensitive resources, such as security software programs, is limited to very few individuals; and (4) network security configurations are optimized to provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment.

Certain procedural and technical access controls over OSM's financial applications have not been implemented or are not operating effectively to minimize the risks of unauthorized access to its systems and its data.

Recommendation

We recommend the OSM continue the development and implementation of its formal action plan to improve the internal security and general 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 electronic data processing (EDP) control environment to ensure adequate security and protection of the OSM's financial management systems.

B. Internal Control Over Charge Cards

The OSM, through the Department of the Interior (Interior), has provided purchasing and travel cards to its employees to streamline acquisition and payment procedures and to reduce the administrative burden associated with traditional and emergency purchasing of travel items, supplies, and services. During fiscal year 2003, the OSM had approximately 750 active charge cards, which included purchase, travel, fleet, and corporate cards. These cards were used in transactions during fiscal year 2003 totaling approximately \$20 million.

In conjunction with the issuance of the cards, Interior has published guidance and instructions on the card's utilization through its Integrated Charge Card Program Guide. This policy sets forth restrictions on the use of the cards as well as certain internal control procedures such as timely and complete reconciliation of billing statements by the cardholders and approving officials.

As part of our audit we reviewed a sample of 45 cardholder statements for the timely completion of monthly charge card reconciliations, which included cardholder and approving official review and a description of each charge. Our test work revealed the following exceptions:

- 41 of the 45 statements were either not signed or dated by the cardholder or not signed in a timely manner (within one month of statement date). Six of these 41 statements could not be obtained at all.
- 38 of the 45 statements did not include a description of each charge.
- 32 of the 45 statements were either not signed or dated by the approving official or not signed in a timely manner (within one month of statement date).

By not ensuring controls are operating effectively, the OSM increases its risk that charge cards may be used for purposes other than official government related business, and that these potential misuses will go uncorrected. Due to the volume of charge card transactions, adequate internal control is important in preventing significant misuse. We believe Interior's established charge card review policies help provide effective internal control when placed into operation, and accordingly, the OSM should take the necessary steps to ensure compliance with these policies. Through improved execution of internal control procedures, the OSM may limit the risks of misuse.

Recommendation

The OSM should ensure compliance with its established charge card policies. To help ensure compliance:

- The OSM should continue to provide training to field office personnel on charge card procedures.
- OSM management, at the field office levels, should be more diligent in monitoring and enforcing compliance with its charge card policies.

We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of the OSM in a separate letter dated October 31, 2003.

Compliance with Laws and Regulations

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

The results of our tests of FFMLA disclosed instances, described below, where the OSM's financial management systems did not substantially comply with Federal financial management systems requirements.

C. Federal Financial Management Systems Requirements

As discussed in the section of our report entitled Internal Control Over Financial Reporting, the OSM needs to improve security and internal control over information technology systems. The OSM has not finalized security policies for one of its financial support applications, has not always performed employee background investigations consistently and/or in a timely manner, and has not implemented certain procedural and technical access controls over its financial applications to minimize the risks of unauthorized access to its systems and its data. As a result, the OSM does not substantially comply with the security and general EDP control requirements of OMB Circular A-130, *Management of Federal Information Resources*.

Recommendation

We recommend the OSM improve its security and internal control over information technology systems to a level in which OSM substantially complies with the security and general EDP control requirements of OMB Circular A-130, *Management of Federal Information Resources*.

The results of our tests of FFMLA disclosed no instances in which the OSM's financial management systems did not substantially comply with the Federal accounting standards or the United States Standard General Ledger at the transaction level.

Responsibilities

Management's Responsibilities

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

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;
- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures) and required supplementary information; and
- Complying with laws and regulations, including FFMIA.

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

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2003 and 2002 financial statements of the OSM based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

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

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

In planning and performing our fiscal year 2003 audit, we considered the OSM's internal control over financial reporting by obtaining an understanding of the OSM's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

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

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

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the OSM's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

Distribution

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

KPMG LLP

October 31, 2003



United States Department of the Interior

OFFICE OF SURFACE MINING
RECLAMATION AND ENFORCEMENT
Washington, D.C. 20240



Memorandum

To: Roger La Rouche
Assistant Inspector General for Audits

From: Jeffrey Jarrett *Jeffrey Jarrett* NOV 5 2003
Director, Office of Surface Mining Reclamation and Enforcement

Subject: Draft Independent Auditor's Report on the Office of Surface Mining
Reclamation and Enforcement's Financial Statements for Fiscal Years
2003 and 2002

We have reviewed the Draft Independent Auditor's Report (Report) referenced above. We concur with all the findings and recommendations included in the Report. The following comments include our status of implementing those recommendations.

Internal Control Over Financial Reporting

A. Security and Internal Control Over Information Technology Systems

Security Programs

Included in the security programs section of the Report are two separate items. One item relates to a security policy for the Federal Personnel/Payroll System, and one item relates to employee background investigations.

Recommendation: Develop and implement security policy for access to the Department's Federal Personnel/ Payroll System (FPPS).

Status of Implementation: We completed a security policy for our access to FPPS. As appropriate, our security plan incorporates guidance supplied by the Department relative to FPPS and addresses only those aspects relevant to OSM. The following was considered in developing our security policy:

- Application Rules
- Personnel Security
- Technical Controls
- Information Sharing

We implemented this security plan during the last quarter in Fiscal Year 2003.

Responsible Official: Assistant Director for Finance and Administration.

Recommendation: Implement changes to improve the process of background investigations to ensure that investigations occur consistently and in a timely manner.

Status of Implementation: We developed a new plan that includes validating not only security for those as required by regulation, but we will initiate background investigations on all new hires no matter what the appointment time limit. We have also instituted a policy of closer review and monitoring of all background investigations. We implemented this new plan during the last quarter in Fiscal Year 2003.

Responsible Official: Assistant Director for Finance and Administration.

Access Controls

Recommendation: Review the vulnerability assessment results and ensure that appropriate corrective actions have been implemented to address the specific high-risk vulnerabilities identified for the bureau, and evaluate the process for identifying vulnerabilities on the internal network and ensure that thorough, periodic reviews are conducted to identify internal vulnerabilities.

Status of Implementation: As noted in our response to this Notice of Finding and Recommendation (OSM-2003-03), OSM took immediate action to correct the weaknesses identified as a result of the vulnerability assessment performed by the auditors. We have evaluated our process for identifying vulnerabilities on the internal network and we have implemented a process of conducting thorough, periodic reviews in order to identify vulnerabilities. We implemented this process during the last quarter in Fiscal Year 2003.

Responsible Official: Assistant Director for Finance and Administration.

B. Internal Control Over Charge Cards

Recommendation: OSM should ensure compliance with its established charge card policies. To help ensure compliance OSM should continue to provide training to field office personnel on charge card procedures. OSM management, at the field office levels, should be more diligent in monitoring and enforcing compliance with its charge card policies.

Status of Implementation: We developed a plan to improve the internal control over charge purchases, including ensuring compliance with charge card policies. The plan includes issuing a revised policy detailing the requirements for both

cardholders and approving officials. This policy was issued on November 4, 2003 by OSM's Deputy Director.

In addition, during Fiscal Year 2004, we have plans to provide mandatory training for all cardholders and approving officials. We also plan to conduct random audits of compliance with internal controls on a quarterly basis. Lastly, we intend to revise, Approving Officials' performance standards to include a critical element which covers their responsibility to ensure proper internal controls over charge card purchases of their employees.

It is important to note that, in the audit of the charge card activity our auditors found no instances of inappropriate charges. The OSM Division of Financial Management routinely reviews exception reports and immediately follows up on suspicious charge card transactions or unusual purchasing patterns. OSM believes that this review process is a very effective internal control and will continue to perform this function.

Responsible Official: Assistant Director for Finance and Administration

Compliance with Laws and Regulations

C. Federal Financial Management Systems Requirements

Please see our comments above under the Internal Control of Financial Reporting regarding our status of improving the security and internal controls over our information technology systems.

We appreciate the opportunity to comment on the Report. If you have any questions regarding our comments, please contact Esther Horst at (303) 236-0330, extension 301.

OFFICE OF SURFACE MINING

1951 Constitution Ave, N.W.
Washington, DC 20240

www.osmre.gov

