U.S. Department of the Interior

Minerals Management Service

Annual Financial Report
Fiscal Year 2002

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Message from the Director

It is my pleasure to submit to you the Fiscal Year 2002 Annual Financial Report of the Minerals Management Service (MMS).

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

- The Department's Resource Use goal for managing resources to enhance public benefit, promote responsible use, and ensure optimal value in energy areas.

- The Department's Serving Communities goal for protecting lives and property and fulfilling Indian trust responsibilities.

As stewards of the mineral resources on the OCS, and as a leader in offshore safety, science, and environmental responsibility, our Offshore Minerals Management Program is responsible for balancing the Nation's search for energy with the protection of our natural environment. Our commitment to environmental protection and safe operations begins with the first step in the leasing process and continues through the decommissioning of facilities. Oil and natural gas production from the OCS are an important part of the President's National Energy Policy. Not only does OCS production represent over 25 percent of the Nation's domestically produced oil and gas, but a significant part of the royalties from oil are being taken in-kind and used to fill the remaining capacity of the Nation's Strategic Petroleum Reserve. The percentage of oil and gas produced from the OCS is likely to increase in the coming decade because more than 60 percent of the Nation's remaining oil and gas is located offshore.

Our Minerals Revenue Management (MRM) Program, responsible for managing all the revenues generated by Federal offshore and onshore and American Indian mineral leases, is one of the government's greatest sources of non-tax revenues. Using a sophisticated accounting system, the MRM processes more than $500 million each month. Bonuses, rents, and royalties from over 78,000 leases amount to several billion dollars each year. These revenues benefit not only the Federal Treasury and the public but also states and Indians. The MRM handles and distributes these receipts based on various laws.

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

R. M. "Johnnie" Burton

Director

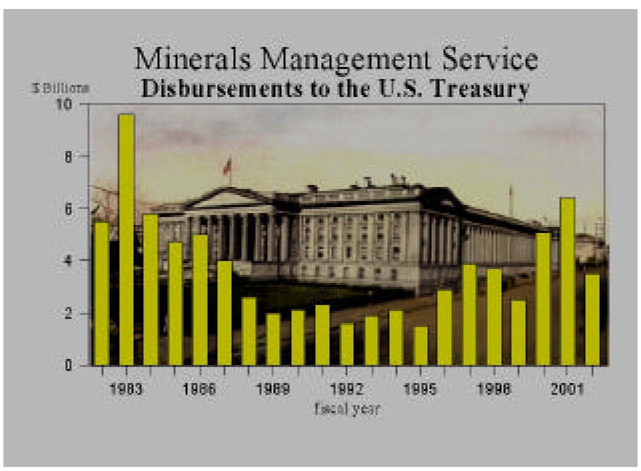
Sperm whale starting dive in waters of 800-1000 meters depth. Whale sighted during MMS funded Sperm Whale Seismic Survey Study, Central Gulf of Mexico Located near a temporary drilling rig and spar platform (BP operation) located on Mississippi Canyon Block 127.
Photo: Christopher Richter

Management's Discussion and Analysis

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

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

As the Nation's designated steward of the mineral resources on the OCS, MMS is committed to achieving the proper balance between providing energy for the American people and protecting unique and sensitive coastal and marine environments. The Federal government has been regulating oil and gas activity on the OCS for almost 50 years, since the enactment of legislation in 1953 when it gained official jurisdiction over the OCS. In that time, over 13 billion barrels of oil and more than 143 trillion cubic feet of natural gas have been produced from the Federal OCS. This production has generated over $138 billion in lease bonuses, rents, and royalty payments. MMS has an excellent environmental and safety record. Because of its regulatory expertise and its successful oversight of environmentally safe and sound operations, MMS is increasingly being called upon to assist and participate in international forums and projects that further our Nation's foreign policy goals.



The establishment of MMS brought an increased emphasis on proper collection and accounting of mineral lease revenues. As collector of revenues from Federal and Indian lands, MMS utilizes a broad range of financial services and pursues a comprehensive compliance strategy to ensure the accuracy and timeliness of revenues received and disbursed in accordance with Federal laws. The business environment in which MMS administers royalty payments is similar in many respects to that in which private and State land minerals owners operate. However, in scale of activity and variety and complexity of lease terms, it is significantly different. Currently, MMS administers the rental, royalty, and other financial terms for over 26,000 producing and 54,500 non-producing mineral leases.

The largest recipient of Federal Mineral Lease Revenues has been the U.S. Treasury. Since 1982 over $78 billion has been deposited to the General Fund of the Treasury. In addition, States have received over $14 billion, the Land and Water Conservation Fund has received over $18 billion, and Indian Tribes and Allottees have received over $3 billion.

President's Management Agenda

Management reform is, and will continue to be, an integral part of MMS operations. Established out of an effort to improve the manner in which proper fiscal accountability and management of the Nation's mineral resources were handled the MMS has always sought to increase the efficiency and effectiveness of its operations. By listening closely and working cooperatively with local citizens, tribal leaders, States, and industry, MMS has been able to achieve many improvements. However, there will always remain challenges and opportunities for further growth.

The Secretary's Plan for Citizen Centered Governance, published in September 2001, outlined the blueprint for implementing the President's Management Agenda (PMA) within DOI. This year's progress report summarizes progress being made at the Department of the Interior and its bureaus on the PMA and outlines steps that will be taken over the next year to continue making progress.

The MMS is working to improve service delivery using the President's management initiatives and the Secretary's vision of effective program management. Our efforts related to the President's Management Agenda initiatives are briefly discussed below.

Strategic Management of Human Capital

We have completed our initial workforce analysis. Using the services of a contractor, we identified projected retirement rates and the drivers that will affect the MMS workforce during the coming years. These include internal changes such as the implementation of the MRM Reengineered systems, the development of the Offshore Minerals Management (OMM) e-Gov initiative, and competitive sourcing outcomes, as well as industry driven changes.

In each of these areas, MMS already has experienced changes and expects to see more. The MRM's reengineering initiative with its redesigned work processes and continued use of technology to achieve program efficiencies and attain goals has challenged MRM to develop new skill mixes. In addition, plans to initiate an e-Government improvement in OMM will bring about significant changes in work processes that will require a new set of skills for current and future OMM employees. In line with requirements to downsize the Pacific OCS Regional Office, we assessed the workforce identifying skills and positions needed to continue operations as well as skills and positions that would no longer be required. We then attempted to match the skills and positions that would no longer be needed in the Pacific Office with requirements in other parts of our bureau or sister agencies. We also sought and successfully obtained bureau-wide early-out authority to provide another option for staff who wished to leave government service.

The next step for MMS involves a more detailed look at the implementation of policies and practices that will ensure MMS does not experience critical staffing and skill gaps as the result of the drivers identified and those that are not yet predicted.

Competitive Sourcing

The MMS has from its very beginnings supported the concept of contracting out activities that can more efficiently be handled by the private sector. The MRM systems were contracted out from their inception and the recent reengineering effort has only increased that focus. We contract with States and tribes for the auditing of leases within their boundaries. Our environmental studies and technology assessment research efforts are all contracted out to private firms, State universities, and others.

In keeping with our past practices, MMS supports the concepts of the Federal Activities Inventory Reform Act. We are conducting the comprehensive self-examinations and evaluations of in-house performance and costs relative to the private sector, as required by the

Act, and are in the process of developing appropriate Most Efficient Organizations for the competition process in identified areas. As part of our commitment to improving how government works, we recently completed Competitive Sourcing Plans for FY 2002 and FY 2003. In FY 2002, 5 percent of our positions were subject to competition and, in FY 2003, an additional 10 percent will be competed.

Improving Financial Performance

The MMS has a very good record of financial performance in the area of royalty collections and disbursements and has received unqualified audit opinions in this area. The MMS has responded to recommendations made by the Inspector General and moved aggressively during the past 2 years to improve our administrative financial performance. We hired a new financial management chief and reorganized the financial management staff as recommended by an outside accounting firm. We improved definition of staff responsibilities and functions, internal controls, and expanded training for all staff to assure better compliance with rules and regulations. As a result, we received an unqualified opinion from the independent auditors on our FY 2002 financial statements.

FY 2002 has been a very difficult year for the royalty collections activities. Challenged not only by the implementation of a reengineered system, but also by being cut off from the Internet by a court order for almost 4 months (preventing companies from filing their royalty and production reports), we have worked hard and have been able to maintain our record of unqualified audit opinions in this area.

Expanding Electronic Government

Since MMS's formation, we have sought to find easier, faster, more reliable means of exchanging information with our constituents. We use our Internet web page as one of our primary interfaces with all interested parties and the Internet itself as a means of moving information back and forth between MMS and our constituents. We also recognize that electronic government expansion is an integral part of transforming the way we do business. During the past several years, MMS has undertaken a major reengineering effort that, among other things, is providing constituents improved access to MRM activities through the Internet.

The MMS also initiated an electronic government initiative within our OMM program, e-Government Transformation. During FY 2002, OMM completed the preparation phase of this effort, including the establishment of a Project Management Office. Work completed during FY 2002 included development of a Program Management Plan, Integrated Project Team Charter, Program Management Office Charter, Performance Measures Framework, Risk Management Plan, Communications Plan, Training Baseline, Transformation Plan, IT Blueprint, Security Policy and Plan, Data Strategy, Enterprise Data Model, and Enterprise Architecture. OMM is working to ensure that its resulting Enterprise Architecture is scalable and fully integrated with DOI's Enterprise Architecture. These materials form the foundation for future efforts--a structured, modular approach will include formal re-engineering of OMM's business processes.

The MMS is participating in three Quicksilver initiatives:

- On-Line Permitting
- Electronic Rulemaking
- Electronic Recordkeeping

The MMS has extensive, ongoing efforts to ensure that updated Security Plans are in place along with timely security reviews.

Budget and Performance Integration

The MMS is fully committed to improving this linkage. In accordance with Office of Management and Budget Circular A-11, "Preparation, Submission and Execution of the Budget", MMS is committed to the integration of budget and performance data. To that end, the MMS Annual Performance Plan includes figures for our mission goals that were determined by evaluating the contributions of the various parts of the organization toward each of the goals. The entire cost for the MMS, including general and administrative costs, is allocated to the mission goals. The total for all mission goals matches the MMS totals in our budget submission.

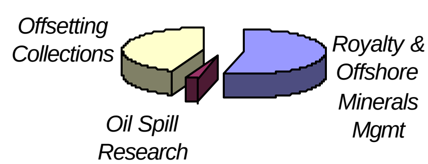
While MMS tracked outputs on a manual basis during FY 2002 and previously, we have developed an automated means of tracking and analyzing both activities and costs. The MMS is one of two bureaus tasked with applying activity based costing (ABC) methods to our operations by FY 2003. ABC will provide managers with information they can use to monitor and evaluate their program performance, allocate resources more effectively, and measure results. The ABC also is a tool that will help in the implementation of the President's management initiative on budget and performance integration. Costing activities have been identified across the bureau. Staffs are being trained in the proper recording of their time to these cost activities. Efforts have been undertaken to identify appropriate outputs to be measured by ABC methods. Beginning in FY 2003, MMS will have an ABC system in place and operating.

Organization and Funding

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

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

Minerals Management Service
Major Sources of Funding
fiscal year 2002



The MMS's operations are primarily funded from two appropriations: Royalty and Offshore Minerals Management (ROMM) and Oil Spill Research (OSR); and offsetting collections from OCS activities. MMS was first authorized to utilize offsetting collections to fund a part of our operations in FY 1994. Each year since, MMS's appropriated dollars have been supplemented by these funds. Derived primarily from rents on offshore leases, MMS has utilized over $570 million dollars in offsetting collections since FY 1994. This has reduced by an equal amount our need for appropriated dollars.

Offshore Minerals Management Program

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

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

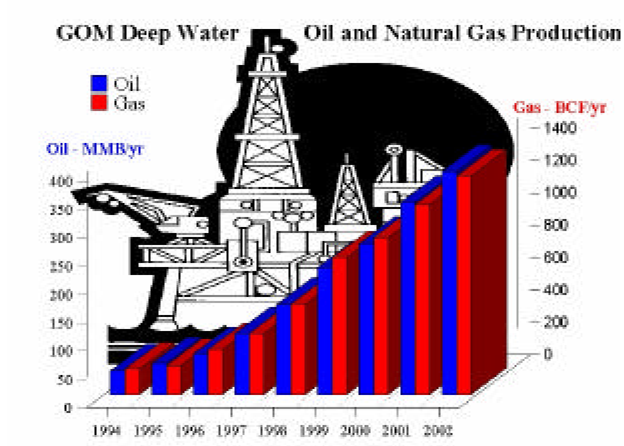
- Help meet the Nation's energy needs;
- Provide for environmentally sound exploration and development of OCS mineral and non-mineral resources;
- Balance the various environmental and resource issues and concerns of affected parties; and
- Assure that the Nation receives Fair Market Value for tracts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

Fiscal Year 2002 OMM Activities

Offshore Oil and Gas in the Gulf of Mexico – In FY 2002, MMS conducted three highly successful oil and gas lease sales in the Gulf of Mexico. Eastern Gulf of Mexico Sale 181 was held on December 5, 2001. Sale 181 attracted $340 million in high bids from 17 companies. On March 20, 2001, Central Gulf of Mexico Lease Sale 182 received $363 million in high bids from 77 companies. Western Gulf of Mexico Sale 184 was held on August 21, 2002. Sale 184 attracted $151 million in high bids from 44 companies.

Immediately following each sale, MMS begins a careful evaluation of all bids to ensure that the public receives fair market value for the areas put up for sale. Only after this process is completed are bids actually accepted and companies able to claim their leases.

Deepwater Production -- Recent exploration successes in deepwater fields in the Gulf of Mexico are of critical importance in providing a vital new domestic source of oil and natural gas. Technological advances are increasing operators' abilities to take advantage of these finds, while reducing the danger and uncertainty in deepwater operations. The Gulf of Mexico's deepwater reservoirs have become America's new frontier for oil and gas exploration. Production potential from proven reserves in deepwater areas is estimated to be roughly 1.8 billion barrels of oil and 5.8 trillion cubic feet of natural gas. Consequently, drilling in the Gulf's Outer Continental Shelf has increased greatly over the last 10 years. Today, deepwater drilling from permanent structures and wildcat wells is at an all-time high. In September 2002, 32 deepwater rigs were drilling in water depths greater than 1,000 feet, as compared to only nine in 1990. The number of wells being drilled in the so-called ultra-deep waters – those in 5,000 feet of water or greater – continues to grow significantly. In FY 2002, 11 different operators drilled a total of 63 wells in ultra deep water. The top ten ultra-deep water-depths along with company for FY 2002 are shown in the table below.



Operator	Water-depth (feet)
Union Oil Co. of California	9727
Kerr-McGee Oil & Gas Corporation	8334
BHP Petroleum (GOM) Inc.	8143
Kerr-McGee Oil & Gas Corporation	8015
Shell Offshore Inc.	8013
Shell Offshore Inc.	8009
Shell Offshore Inc.	7995
Kerr-McGee Oil & Gas Corporation	7919
Marathon Oil Company	7729
Total Final Elf E&P USA, Inc.	7067

Production from deepwater wells is increasing as compared to prior years. In 1985, for example, only six percent of the Gulf's oil production came from deepwater wells as compared to over 50 percent in FY 2001. Natural gas production from deepwater areas in the Gulf has also increased—from less than 1 percent of total production in 1985 to over 20 percent in FY 2001.

Northstar – First Production Offshore -- BP Exploration (Alaska) Inc (BPXA) began production of oil from their Northstar facility in the Alaska Beaufort Sea on October 31, 2001. This is the first oil production from the Federal OCS in Alaska. The Northstar reservoir is managed under a joint Federal/State unit agreement. The Unit is located about six miles offshore of Pt. Storkerson and 12 miles northwest of Prudhoe Bay. The unit includes three federal and five state leases. BPXA is the unit operator with controlling interest in these leases, along with Murphy Oil. The Northstar facility consists of an offshore gravel island located in 39 feet of water within State of Alaska waters, a subsea single-walled pipeline in the Beaufort Sea, and onshore above-ground pipelines that connect Northstar to existing facilities. BPXA recently estimated that the Northstar reserves could be as high as 175 million barrels of recoverable oil.

Currently, 15.9 percent of Northstar reserves is allocated to Federal leases and would represent approximately $120 million in Federal royalty. The Federal leases are also within the OCS designated 8(g) boundaries that entitle the State of Alaska to receive 27 percent of Federal revenues.

Production Continues in the Pacific -- In addition to the continued leasing and production and the deepwater successes in the Gulf of Mexico, the MMS continues to oversee safe and environmentally sound production of oil and natural gas offshore California. Twenty-three platforms continue to produce significant quantities of oil and natural gas. Increasingly, extended-reach wells are being employed in the region. One field for which a separate platform was originally planned, Sacate in the Santa Ynez Unit, is now producing from an existing platform using some of the longest reach wells in the Nation. Production by extended-reach wells will increase in the coming years.

Marine Science -- Since 1973, the MMS Environmental Studies Program has funded over $733 million in scientific research. This research encompasses biological, physical oceanographic, ecological, and socioeconomic issues associated with offshore mineral leasing and development. During FY 2002, research activities were underway on more than 300 different projects, and more than 50 new projects were started.

MMS has established Coastal Marine Institutes (CMIs) in Alaska, California, and Louisiana. Through these CMIs, MMS can leverage its financial resources with those of the States. This arrangement helps both MMS and the States address mutually agreed upon scientific needs regarding the impacts of OCS activities. All research is funded on a 50/50 matching basis. In FY 2002 the CMI partnerships resulted in research awards which matched MMS funds with $4,000,000 of non-Federal funds.

Of particular interest, Dr. Eric R.A.N. Smith, a CMI research scientist at the University of California – Santa Barbara, published the book *Energy, the Environment and Public Opinion*. This book used various research efforts funded by MMS over the last few years and explores the relationship between public opinion and energy development, including the underlying predisposition that lead to perceptions of risk. The book discusses the history of energy problems, along with trends in public opinion, their root causes and implications for the future.

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

Much of the scientific research conducted in FY 2002 continued the emphasis on deepwater development activities in the Gulf of Mexico with studies of:

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

Other major MMS studies addressing critical issues to offshore oil and gas leasing, exploration, and development, as well as non-energy minerals during FY 2002 include:

- Arctic Nearshore Impact Monitoring
- Beaufort and Chukchi Sea and Cook Inlet Ocean Circulation
- Marine Mammal (bowhead whale and polar bear) and Seabird Studies in the Beaufort Sea
- Environmental Monitoring in the California Intertidal and Offshore areas

- Environmental Surveys of Potential Borrow Areas on the Offshore Northern New Jersey and Southern New York Shelf and the Environmental Implications of Sand Removal for Coastal and Beach Restoration
- Environmental Investigation of the Use of Shoals Offshore Maryland by Mobile Benthos and Finfish Species
- Air Quality Model Development for OCS Applications

Office of Management and Budget Program Performance Assessment

Improving programs by focusing on results is an integral component of the President's Budget and Performance Integration Initiative. This year the Office of Management and Budget (OMB) evaluated 20 percent of Federal programs, accounting for more than 24 percent of Federal spending for the FY 2004 Budget. Within MMS, the Environmental Studies Program (ESP) was selected as the first program area to undergo this assessment. The ESP is a relatively small and highly focused R&D program, which places a strong emphasis on strategic planning with development of annual and long-term goals. Critical to its success over the years has been several internal and independent external program reviews, and in particular, the continuous oversight provided by the OCS Scientific Committee. The ESP has maintained its focus on meeting the scientific information needs of a diverse customer base in support of offshore oil and gas and marine minerals management decisions, and has emphasized information transfer through published reports, conference presentations and more recently through the internet. In recognition of these elements, strong financial management practices, and the significant program benefits for the public, the OMB Performance Assessment has rated the MMS ESP as an exemplary federal program.

Five-Year Plan: Secretary Norton approved the Minerals Management Service's 5-Year Program for 2002-2007 in July 2002. The program plans 20 lease sales in eight OCS planning areas in the Gulf of Mexico and off Alaska. The first sale was held this past August in the Western Gulf of Mexico Sale 184. The Secretary's approval culminated an 18-month process during which MMS and the Department of Interior consulted with coastal states, the public at large, the environmental community and the natural and gas industry. The new program supports the President's National Energy Policy and will help meet the future energy needs of our country in an environmentally sound manner. The new program estimates to make available from 10 to 21 billion barrels of oil and 40 to 60 trillion cubic feet of natural gas.

MMS Offshore Sand Cooperative -- Since 1992, MMS has worked cooperatively with States along the east and gulf coasts of the U.S. to locate sand in Federal waters that could be used to protect the Nation's shores and wetlands. These States are New Jersey, Maryland, Delaware, Virginia, North Carolina, South Carolina, Florida, Alabama, Louisiana, and Texas. To date, over 15 million cubic yards of sand has been placed in 11 protection projects.

The MMS has worked closely with the coastal states to help restore damaged or eroded coastlines and has entered into negotiated agreements (leases) with local, state and Federal agencies. The sand once leased is then obtained from federal offshore borrow sites that have been previously identified and placed on the affected beaches.

To be sure that removing the sand will not cause environmental damage the MMS typically works with State officials to develop an environmental assessment which contains stipulations to protect against damage to archaeological resources, wildlife, and endangered species and contains a provision to safeguard against the digging of a deep pit on the ocean floor.

Minerals Revenue Management

The Minerals Revenue Management is a highly integrated, process centered organization that is focused on outcomes. MRM's goal is to provide the best possible services at less cost. Minerals Revenue Management is responsible for collecting revenues earned from the leasing and production of mineral rights on all Federal and most Indian lands and for disbursing these revenues to various recipients as authorized by numerous statutes. The MRM collects mineral leasing revenues from Indian lands and transfers these monies to the Office of Trust Funds Management (OTMF) for distribution to either the appropriate tribe or individual Indian mineral owner.

Some Federal and Indian lands are leased to individuals and companies for minerals development. Leaseholders competitively bid, initially pay a bonus and subsequently, rent for the right to develop these onshore and offshore lands. If minerals are found, extracted and sold, the federal government is entitled to a certain percentage of, or royalty on, the production.

Whereas the MMS's Offshore Program, the Bureau of Indian Affairs (BIA) and the Bureau of Land Management determine lease contract conditions (amount of rent, bonuses or royalty rate to charge or any lease compliance requirements), the MRM does not. MRM's role is to determine the value, to assure the proper measurement of volume and to assure the proper royalty rate is applied to determine the recipient's share of revenues. As part of this role, MRM reviews compliance with regulations, laws, and lease terms, focusing on properties and utilizing newly reengineered tools. Auditors conduct on-site studies of payors' accounting records to determine if the proper amount has been paid. The revenues MMS collects from Federal onshore leases is shared 50 percent with the states in which the lands are located (except for Alaska which receives 90 percent). During the last ten years over $1 billion dollars have been collected through these compliance activities.

The MRM collects and disburses revenues collected on lands administered by the Department of the Interior (the MMS Offshore Minerals Management Program, BIA, and BLM), the U.S. Forest Service, the Army Corps of Engineers, and the U.S. military. MRM works closely with the staffs of these bureaus and MMS offshore program organizations on a continuing basis to improve overall royalty management.

Fiscal Year 2002 MRM Activities

System Reengineering Initiative -- During FY 2002, MMS continued the implementation and refinement of a new system infrastructure to support our reengineered business processes. The build phase, completed in early FY 2002, included substantial testing, training, and conversion activities. MRM engaged Accenture to develop and implement the new, integrated minerals revenue management system consisting of a PeopleSoft financial module, a Compliance and Asset Management (CAM) module, a relational database environment, a robust data warehouse, and a variety of technology tools. MMS implemented the PeopleSoft core software for the new financial system on November 1, 2001 and continued to phase in other components during FY 2002.

While the core financial system was implemented successfully in November 2001, the system shakedown, a critical phase following a major system implementation, was interrupted by the court ordered Internet shutdown on December 6, 2001. The MRM systems were out of operation from December 2001 through March 2002. MRM and Accenture were unable to conduct normal financial processing—thus creating major processing backlogs—nor develop, test, and implement software fixes and enhancements or implement key subsystems. Following approval to reconnect, MRM focused its attention on processing the backlogs of mineral revenue reports, with priority on Indian revenues. Note that during the shutdown, companies were still required to pay revenues due: MRM was able to collect and deposit these revenues and make estimated payments to States and the OTFM made estimated payments to Individual Indian Allottees. The CAM and data warehouse systems were also seriously affected by the shutdown. While these processes are less time-critical than financial processing, MRM nonetheless lost valuable time and resources in its efforts to implement a fully functional compliance system.

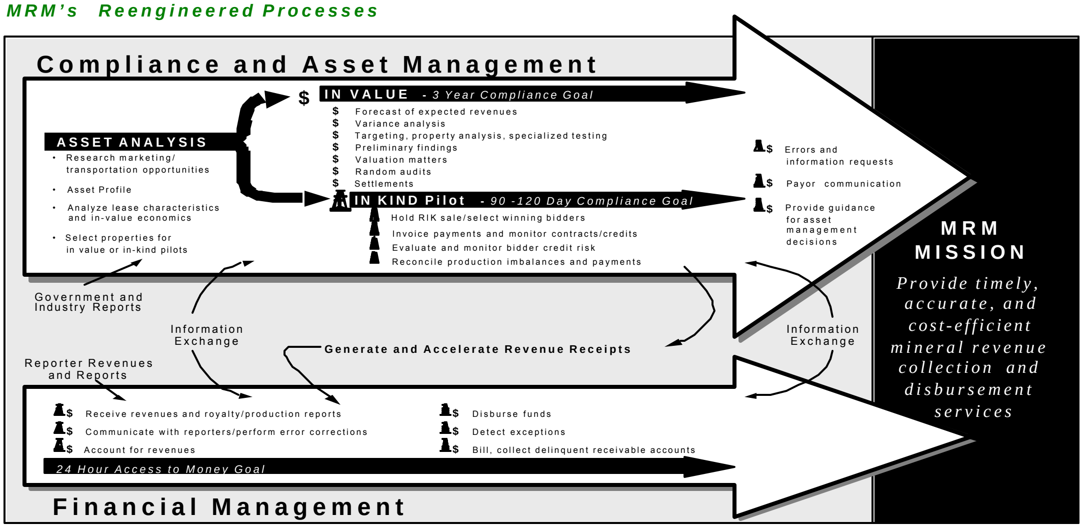
The mineral revenue backlogs have been eliminated, but production reports are still backlogged and other key subsystems and software fixes are in development and testing phases. MRM is applying additional contract resources to the financial module, the CAM module, and the data warehouse in an effort to recover from the impacts of the ill-timed shutdown. Major efforts include developing and implementing critical software improvements and improving system throughput, response time, and functionality. When fully implemented, the reengineered end-to-end business processes will help us achieve our goals while supporting a strong emphasis on our Indian trust responsibilities.

- The financial management process will greatly enhance MRM's goal to provide recipients access to their mineral revenues within one business day of MRM receipt.

- The compliance and asset management process will help MRM reduce the business cycle time by 50 percent.

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

MRM's Reengineered Processes



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

Indian Trust Responsibilities - The MMS serves American Indian tribes and individual American Indian mineral owners by ensuring that they receive accurate returns for mineral production on their lands. While working to guard American Indian mineral interests, MMS also emphasizes American Indian empowerment through government to government relationships. We coordinate with eight tribes that choose to handle their own royalty audit work through cooperative agreements. When we restructured our organization in October 2000, we reemphasized our focus on Indian Trust responsibilities by establishing the Indian Compliance and Asset Management section, specifically dedicated to serving mineral producing tribes and individual Indian mineral owners (allottees). Based at the Denver offices of MMS's MRM, this service organization is augmented by team sites in New Mexico and Oklahoma. It serves as a focal point for both Indian mineral issues and contact with the Indian community, allottees, and involved federal agencies to resolve Indian mineral related issues.

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

Royalty in Kind (RIK) - MRM's Reengineering Initiative established core business processes and organizational structures to support its future asset management approach for administering Federal oil and gas royalties. RIK is a critical component of this strategy. Although MMS has had the authority to collect oil and gas royalties either in cash or in kind, it historically focused on the cash approach. One exception has been the long-standing Small Refiner Program. However, significant advances have been made by MMS since 1997 in evaluating the feasibility of competitive RIK strategies, and developing and successfully operating a series of RIK pilot projects to test the viability of the approach. Through the operation of the pilot projects and the Small Refiner Program, MMS has well positioned itself to take the next logical step in the development of the RIK approach.

In January 2001, the MMS published its RIK Road Map to the Future. The Road Map is a three-year implementation plan designed to evolve and integrate the RIK option into MMS asset management strategy. The key focus areas of the Road Map include development of business processes and organization; acquisition of enabling technology to support RIK activities; and definition of future information reporting requirements. The MRM is utilizing the Operational Model approach to support and manage the Road Map implementation as well as the continued operation of the RIK pilots and Small Refiner Program. The RIK pilots for FY 2001-2002 include competitive sales of oil production in Wyoming, the Pacific OCS and the Gulf of Mexico OCS, and natural gas in the Gulf of Mexico OCS. MMS is continuing to assess the results of these pilots and incorporating the findings in the further evolution of RIK business strategies. In March 2001, MMS published its draft assessment report on the Wyoming Pilot. The draft report concluded that the RIK approach used in Wyoming was a viable option in managing the royalty asset. MMS completed its assessment of the first RIK gas pilot in the Gulf of Mexico and issued the draft report in March 2002. The draft report concluded that the RIK approach was a viable approach for managing the natural gas royalty asset in the Gulf of

Mexico. The draft report found that RIK natural gas sales at market centers will generally receive the same price as any other gas sold at the same market centers. The draft report further states that significant RIK value uplifts can be received from favorable transportation contracts resulting from the large Federal production volume position. Additional evaluations of Gulf of Mexico oil and gas pilots will be conducted in FY 2002 and 2003.

Significant investments in technology to support the RIK process began in FY 2002 and continues in FY 2003. MMS's systems contractor began development of a needed gas management system to support its natural gas RIK business activities. The gas management system is scheduled for implementation in January 2003. In FY 2003, a liquids management system and risk management system will be developed with full implementation scheduled for October 2003. These systems investments are critical to evolution and integration of the RIK option into the MMS asset management strategy.

Strategic Petroleum Reserve

On November 13, 2001, the President made the decision to proceed with the utilization of Gulf of Mexico royalty oil to fill the remaining storage capacity of the Strategic Petroleum Reserve (SPR). With the President's decision, the MMS and Department of Energy established a joint initiative to accomplish the fill. The first deliveries of RIK oil to DOE commenced April 1, 2002, and at a rate of 60,000 barrels per day. The fill rate will increase October 1, 2002, by an additional 40,000 barrels per day for a total of 100,000 barrels per day. The final fill rate increase is scheduled for April 1, 2003, with the total fill rate being 130,000 barrels per day until completion of the fill in 2005. It is estimated that over 120 million barrels of Gulf of Mexico RIK oil will be delivered to DOE to complete the SPR fill.

GovWorks

In 1996, the Department of the Interior was authorized by OMB to establish, pursuant to the Government Management Reform Act (GMRA) of 1994, one of six franchise fund pilot programs within the federal government. The objective of the franchise fund pilot program is to ultimately reduce the cost of government to the taxpayer by providing commonly required administrative products and services to other federal agencies on a competitive, fee-for-service basis. The Interior Franchise Fund (IFF) carries out this responsibility by relying upon a network of service provider organizations. MMS's GovWorks operation is one of those providers. In the area of procurement support services, MMS provides a complete range of acquisition services from inception to closeout (i.e., project planning, request for proposals, awards, and closeout of contracts). GovWorks operates in a business-like manner, consistent with OMB's "Twelve Business Principles" and can rapidly assist other agencies with its customer-focused contracting staff. With six years of experience, GovWorks has made impressive progress towards meeting the objectives of the franchise pilot program with approximately 3,000 contracts awarded in FY 2002 totaling approximately $500 million for several hundred government-wide customers.

GovWorks offers professional acquisition and Federal Assistance planning and strategy, with specialties in the following areas:

Advisory and Assistance Studies	**Information Technology, including Hardware, Software and Services**
Telecommunications	**Research and Development**
Engineering and Technical Studies	**Environmental Studies**
Consulting Studies	**Master and Enterprise Licensing Solutions**
Cooperative Agreements and Grants	**Architecture and Engineering**
Business Process Re-engineering	**Facilities Management Systems**
Integrated Logistics Support and Analysis	**Sustaining Engineering**
Joint Military Program Support	**Fleet/Field Support Analysis**
E-Health Portal and Web Site Development	**Engineering Change Proposals**

By memorandum dated September 30, 2002, the Department of the Interior's Assistant Secretary for Policy, Management and Budget determined that Gov.Works will be the sole service provider for Interior's Franchise Fund commencing October 1, 2002. The memorandum directed the National Business Center to remove its agreements from the fund and gave financial management and reporting responsibilities to the Minerals Management Service.

Government Performance and Results Act

MMS is committed to measuring its performance and managing for results as required by the Government Performance and Results Act. As stewards of the mineral resources of the Outer Continental Shelf (OCS), the MMS Offshore Minerals Management program (OMM) provides leadership in the areas of offshore safety, science, and the environment. The Minerals Revenue Management program (MRM) ensures the timely and accurate collection, verification, and disbursement of mineral revenues from Federal and Indian lands.

The Department of the Interior has five broad goals that provide a framework for the numerous and diverse responsibilities of Interior's bureaus.[1]

- Protect the environment and preserve our nation's natural and cultural resources
- Provide recreation for America.
- Manage natural resources for a healthy environment and a strong economy.
- Provide science for a changing world.
- Meet our trust responsibilities to Indian tribes and our commitments to island communities.

The breadth of MMS activities needed to effectively fulfill the MMS mission generally support all of the departmental goals. However, our mandated mission and long-term goals contribute most strongly to the departmental goals to manage natural resources for a healthy environment and a strong economy and to meet our trust responsibilities to Indian tribes.

Manage Natural Resources for a Healthy Environment and a Strong Economy

The MMS mission goals that support this departmental goal are:

- Ensure safe OCS mineral development.
- Ensure environmentally sound OCS mineral development.
- Ensure that the public receives fair market value for OCS mineral development.
- Provide revenue recipients with access to their money within 24 hours of the due date.
- Assure compliance with applicable laws; lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date.
- Interact with our customers in an open and constructive manner to ensure that we provide quality services to satisfy our customers' needs.

Our inspection and oversight of industry activities on the OCS have helped achieve an outstanding safety and environmental record. Our mission goals are designed to continually improve upon this excellent record. In addition, the evolution of the oil and gas industry in recent years as a result of new technologies, consolidations, and mergers has presented us with new challenges to improve the accuracy and timeliness of mineral revenue collections and disbursement and to improve industry compliance with our regulations. MMS is meeting those challenges by implementing new business processes for managing mineral assets.

Meet our trust responsibilities to Indian tribes and our commitments to island communities.

The MMS mission goals that support this departmental goal are:

- Fulfill our mineral revenue Indian trust responsibilities.
- Interact with our customers in an open and constructive manner to ensure that we provide quality services to satisfy our customers' needs.

The objective of these goals is to provide the highest possible Indian trust protection relative to our role in collecting and disbursing royalties on Indian lands. We are focusing our efforts on the accuracy and timeliness of collections and disbursement and industry compliance to ensure that Indian tribes and allottees receive all monies due to them.

MMS offers a number of opportunities to tribes, including access to automated systems, an Indian internship program for on-the-job-training, and handling royalty audit work through cooperative agreements. These efforts will assist the tribes in assuming royalty functions and further improve the government to government relationship with the tribes.

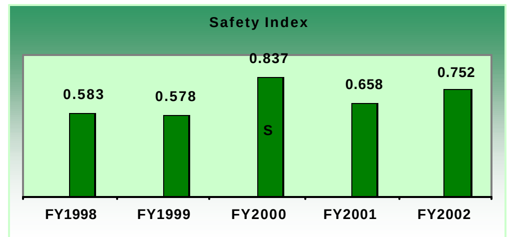
Mission Goal:	**Ensure safe OCS mineral development**
Long Term Goal:	**Maintain or show a decrease in the safety index of .594**
FY 2002 Annual Goal:	**Achieve a safety index not greater .594.**

Today's offshore oil and gas industry is global in scope. MMS continues to expand its collaborative projects with other technologically advanced regulatory countries to promote safe and environmentally sound oil and gas operations worldwide. MMS's offshore minerals

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

management program was created as a result of the Outer Continental Shelf Lands Act of 1953 (OCSLA), which provides for the expeditious and orderly development of minerals on the OCS in an environmentally sound manner. The OCSLA established a mandate for managing natural resources on the OCS. The primary facets of this mandate are to: (1) make OCS lands available for mineral development to meet national needs; (2) ensure that any mineral development occurs in a safe and environmentally sound manner; and (3) ensure that the public receives fair market value for making these mineral resources available.

The FY 2002 safety index was .752, which is higher than last year's index of .658, but is lower than the FY 2000 index of .837. The accident severity in FY 2002 was about the same as in FY 2001, but the activity level dropped significantly. The number of wells drilled and completed and the number of wells abandoned both decreased in FY 2002.



The safety index is the ratio of the number of incidents X severity factor to the number of activities X complexity/risk factor.

We will continue to employ strategies and enhancements to the safety program to address the issue of serious injuries and fatalities.

Mission Goal:	**Ensure environmentally sound OCS mineral development.**
Long Term Goal:	**By 2005, show a decrease in the environmental impact indicator from the1999 baseline.**
FY 2002 Annual Goal:	**In FY 2002, show a decrease in the environmental impact indicator below the 1999 level 8.10 and maintain an oil spill rate of no more than 10 barrels spilled per million barrels produced.**

We cannot submit a report on this annual goal as this time. The index is calculated by calendar year. OMM is continuing to gather the data for calendar year 2002. Additionally, the calendar year 2002 annual review of oil spill data has not been performed; it will be performed between January and March 2003. We anticipate both results by the middle of March 2003 and will post these results to the MMS website (www.mms.gov).

MMS did not report the FY 2001 environmental index result in last year's report because it was not available. The goal was: "Show a decrease in the number of adverse environmental impacts per OCS mineral development activity below the 1998 baseline." The result for 2001 was 7.46, which exceeded the target because the 1998 baseline was 10.25. The rate was based on calculations derived from data on four resource activities in the three OCS regions. This was an increase over the year 2000 results of 5.02, primarily because of more stringent air quality inspections on the Pacific OCS.

We did not report the FY 2001 oil spill result last year because of the reasons mentioned above, so we are reporting it here. The FY 2001 rate was 1.00 barrel spilled per million barrels produced (588 barrels spilled/586.86 million barrels produced). The low FY 2001 rate of 1.00 barrel spilled per million barrels produced was primarily due to having no 'large' spills of 1,000 barrels or greater in FY 2001.

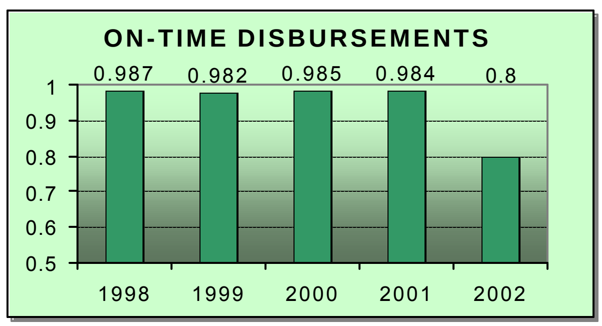
The Federal government is the largest mineral royalty owner in the United States. The Minerals Management Service is responsible for ensuring that annual revenues from Federal and Indian mineral leases are collected, accounted for, verified, and disbursed to appropriate recipients in a timely manner. MMS collected and disbursed more than $10 billion in 2001 to Federal agencies, U.S. Treasury accounts, States, and the Office of Trust Funds Management on behalf of Indian tribes and individual Indian mineral owners.

Mission Goal:	**Ensure that the public receives fair market value for OCS mineral development.**
Long Term Goal:	**MMS' estimate of value or the minimum bid is maintained at the 1989-1995 average level of 1.8 (+/-0.4) to 1. From 2000-2005, the ratio of high bids accepted for OCS leases to the greater of MMS' estimate of value or the minimum bid is maintained at the 1989-1995 average level of 1.8 (+/- 0.4) to 1.**
FY 2002 Annual Goal:	**In FY 2002, we will maintain the current high bids accepted for OCS leases to MMS' estimated value ratio of 1.8 (+0.4) to 1.**

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

Mission Goal:	**Provide revenue recipients with access to their money within the 24 hours of the due date.**
Long Term Goal:	**By the end of FY 2005, provide recipients access to 90 percent of revenues within one business day of receipt and disburse 98 percent of revenues to recipients by the end of the month following month received.**
FY 2002 Annual Goal:	**By the end of FY 2002, provide access for ultimate recipients of 10 percent of revenues within one business day of MMS receipt and disburse 98 percent of revenues to recipients by the end of the month following month received.**

The MMS is working to improve disbursement timeliness and provide recipients access to mineral revenues by the end of the business day following the day of receipt. Additionally, MMS continues to ensure that it disburses funds as required by law, by the end of the month following the month of receipt.

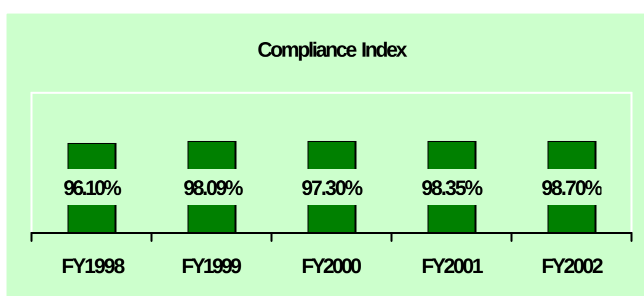


MMS achieved an on-time disbursement rate of only 80 percent in FY 2002, and we did not achieve our access to revenues goal. We are behind because of a court-ordered system shutdown from December 2001 through March 2002. The shutdown prevented MMS from providing detailed supporting mineral revenue data along with mineral revenue payments to states. MMS made estimated payments to states from December 2001 to July 2002 to minimize the disruption of their mineral revenue stream. Note that because of the shutdown, data are available only for Federal leases and only for the fourth quarter.

Mission Goal:	**Assure compliance with applicable laws, lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date.**
Long Term Goal:	**MMS has two long term goals for royalty compliance: The first is "By the end of FY 2005, ensure payments are within the expected payment range at the due date for 95 percent of properties." This goal was established in MMS's FY 2000 – 2005 Strategic Plan in anticipation of the completion of MRM's reengineering initiative.**
FY 2002 Annual Goal:	**In FY 2002, achieve a compliance index of .9775 (for calendar year 2000).**
Long Term Goal:	**The second long term compliance goal is "By the end of FY 2005, complete compliance work and issue necessary orders within 3 years of the due date for 95 percent of royalties associated with 1999 converted properties and through the company cycle-order state for 90 percent of royalties associated with year 2000 converted properties.**

For the first annual goal, we compared the value expected for mineral royalty payments with actual reports and payments using a compliance index model. The model calculates the index with available systems information and public price data. Before we calculate the index, we wait one year for industry to make adjustments to their royalty and production reports and payments. The index reported for 2002 was for calendar year 2000. The result was .987, which exceeded the target.

Until the end of FY 2002, we used the compliance index as the measurement most closely aligning with our long-term goal. For FY 2003, we will use a new compliance measurement methodology that will best reflect this goal. As with the compliance index, the new measure will focus on compliance with expected values for defined producing areas and properties. In addition, MMS intends to determine compliance on a real time basis, instead of waiting two years as is currently required.



We exceeded the target for the first part of the second compliance goal by completing 97.2 percent of the compliance work related to the goal. We have almost completed work on the CY 1999 converted properties from our operational models, representing $416.5 million in total royalties. MRM's Compliance Asset Management staff and Colorado auditors will continue to work on the remaining properties, which represent lower dollars.

However, we are behind target on the second part of the goal due to the system shutdown and recovery efforts mentioned above. We only completed work on 50 percent of the royalties. Once we regained system access, our priority focus was on completing work on CY 1999 properties. The CY 2000 converted properties include properties in our 3-year compliance cycle, representing $2.7 billion total royalties.

Mission Goal:	**Fulfill our mineral revenue Indian trust responsibilities.**
Long Term Goal:	**MMS has long term goals related the DOI's Indian trust responsibility goal. The first is "By the end of Fy2005, ensure 100 percent of Indian gas producing properties are in compliance with index zone/major portion and dual accounting requirements for the period 1984-2004."**
FY 2002 Annual Goal:	**By the end of FY 2002, ensure for the time period January 1, 2000, through March 31, 2002, that 64 percent of Indian gas producing properties are in compliance with index zone/major portion requirements. By the end of FY 2002, ensure for the time period 1984-1999 that 85 percent of Indian gas producing properties are in compliance with dual accounting requirements.**
Long Term Goal:	**The second long term goal is: "By the end of FY 2005, ensure 100 percent of Indian oil producing properties are in compliance with major portion for the time period 1984-2004."**
FY 2002 Annual Goal:	**By the end of FY 2002, ensure for the time period 1984-2001 that 30 percent of Indian oil producing properties are in compliance with major portion requirements.**

We achieved 100 percent of our gas index zone/major portion target. Note that to align with the 3-year compliance goal, we revised the FY 2002 reporting universe to include only the CY

2000 properties completed. In FY 2003, we will report on our progress toward CY 2001. We also exceeded our Dual Accounting goal. There are only 84 companies with 695 leases remaining to be completed. In addition to project lease coverage, MRM audits have assured DA compliance for 2,780 additional lease-payor combinations, representing low dollar leases and others not in the original universe.

We do not plan to make any additional progress on the oil annual goal until after the new Indian Oil rule is published. Once the new Indian oil rule is published, we will develop a new oil goal from the effective date of the new rule. Note that for March 1988 to the present, we are not calculating major portion due to IBLA decisions. To date, all progress with oil major portion has been made through settlements with companies.

Mission Goal:	**Interact with our customers in an open and constructive manner to ensure that we provide quality services to satisfy our customers' needs.**
Long Term Goal:	**By 2005, show an increase in customer satisfaction with our data and information services.**
FY 2002 Annual Goal:	**In FY 2002, we will establish a baseline customer satisfaction index.**

We did not achieve this annual goal. We developed the baseline customer service survey, but did not administer it. Upon further managerial review of the survey, especially in light of discussions during the development of the Department's strategic plan, we decided that the survey would not be useful to management.

Discussion and Analysis of the Financial Statements

MMS's goal is to achieve unqualified (clean) audit opinions on all financial statements and to eliminate all reportable conditions related to internal controls and material instances of non-compliance with the Federal Financial Management Improvement Act (FFMIA) requirements. In fiscal year 2001, MMS only received an unqualified opinion on its Balance Sheet and the Statement of Custodial Activity. An unqualified opinion has been rendered on the full set of financial statements for Fiscal Year 2002. Additionally, MMS has been able to make improvements in eliminating some of the reportable conditions noted in the FY 2001 independent auditor's report. However, MMS has not been able to eliminate all reportable conditions with FFMIA requirements in FY 2002.

Limitations of Financial Statements

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

Expenses

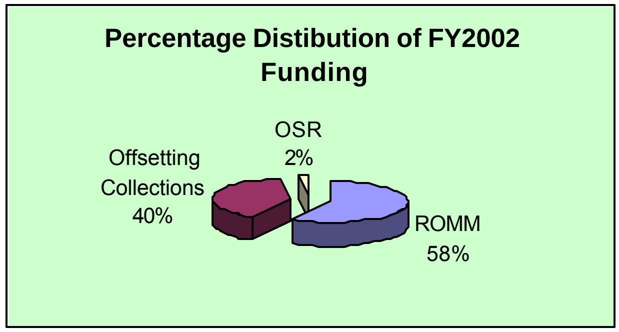
As reflected on the Statement of Net Cost, the 2002 gross cost of the MMS, before earned revenue was approximately $2.18 billion, an increase of approximately $565 million over amounts reported in fiscal year 2001. This increase is primarily attributable to: the accrual of approximately $550 million for contingent liabilities; a $115 million settlement to buy back oil and gas leases in the Destin Dome area off the Florida coast; a $300 million reduction in custodial distributions to States which is consistent with the decline in custodial revenues discussed in the “Revenues” section that follows; and an increase of $165 million in contractual services. The Minerals Leasing Act (MLA), 30 U.S.C. 181 et seq., provides that States be paid 50 percent of the revenues resulting from the leasing of mineral resources on Federal public domain lands within their borders, except Alaska which received 90 percent. In accordance with OMB Bulletin 01-09, the Statement of Net Cost presents costs aligned directly to the major goals and outputs described in the bureau’s performance plans: (1) Safety -- Ensure safe OCS mineral development; (2) Environment -- Ensure environmentally sound OCS mineral development; (3) Fair Market Value -- Ensure that the public receives fair market value for OCS mineral development; (4)Access to Money -- Provide revenue recipients with access to their money within 24 hours of the due date; and (5) Royalty Compliance -- Assure compliance with applicable laws, lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date (Royalty Compliance). GovWorks (Franchise Fund) costs are also presented as a separate responsibility segment.

Revenue

The MMS has custodial revenues of approximately $6.6 billion in Fiscal Year 2002, a decrease of approximately 33% from FY 2001, which is a result of a decrease in both prices and production. The revenues are from Outer Continental Shelf and onshore oil, gas, and mineral lease sales and royalties, making MMS one of the custodians in the Federal government. These revenues are presented on the MMS’s Statement of Custodial Activity since these revenues, under Federal accounting rules, are considered to be revenue to the government as a whole rather than to the MMS or the Department. These revenues are collected by MMS on behalf of the U.S. Treasury, other Federal agencies, States, Indian Tribes and Individual Indian Allottees. Consequently, such revenues are not considered revenues of MMS and are not reported on MMS’ Statement of Net Cost or Statement of Changes in Financial Position. The Federal portion of these revenues is ultimately reported as revenues in the financial statements of those Federal agencies who receive distributions from MMS.

Budgetary Resources

MMS receives funding for operations from three sources: the Royalty and Offshore Minerals Management (ROMM) appropriation, Oil Spill Research (OSR), and offsetting collections (primarily from rental receipts from offshore leases). For FY 2002, the MMS had total annual appropriated resources of $253.4 million, of which $102.7 million was from offsetting collections.



Liabilities and Net Position

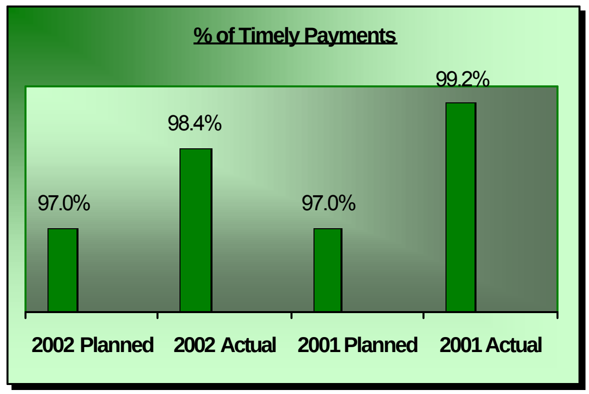
Federal agencies, by law, cannot make any payments unless Congress has appropriated funds. MMS' unfunded liabilities, excluding the accrued liability to the states, is approximately $572 million for fiscal year 2002. In addition to the accrued contingent liability discussed below, this amount consists of annual leave and unfunded workers compensation claims under the Federal Employees Compensation Act which are considered an expense and liability in the current year, but which will be paid out of funds made available to the agency in future years.

The Net Position of the bureau consists of (1) Unexpended Appropriations, (2) Cumulative Results of Operations, and (3) Restricted Equity for the Environmental Improvement Restoration Fund (EIRF). MMS's Net Position as of September 30, 2002 is $491 million, of which $6 million is Unexpended Appropriations, a deficit of $482 million is Cumulative Results of Operations and $967 million is Restricted Equity for the EIRF.

The Unexpended Appropriations represents spending authority appropriated by Congress that has not yet been used. Cumulative Results of Operations is the net results of the bureau's operations over time, and is a deficit at September 30, 2002 because a contingent liability has been accrued in the accompanying financial statements related to a pending lawsuit. It is legal counsel's opinion that any ultimate liability associated with this case will be funded by the Department of Justice's Judgment Fund. At which time, MMS will recognize such revenues and the deficit will be eliminated. The Restricted Equity for the EIRF results from a June 29, 2000 U.S. Supreme Court decree settling a long-standing dispute between the state of Alaska and the Federal government over the State/Federal boundary of areas leased for oil and gas in the Beaufort Sea.

Financial Performance

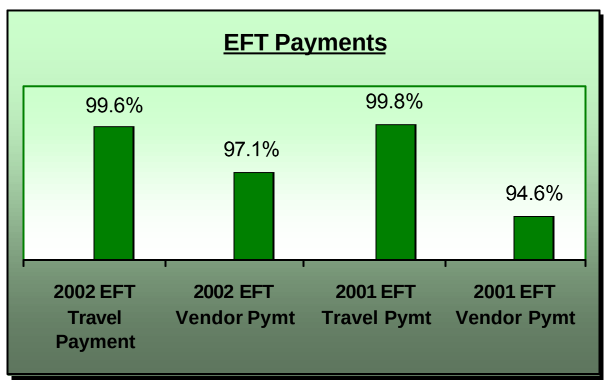
The MMS monitors financial management performance through periodic, collection and reporting of data for the Prompt Payment, Electronic Funds Transfers, and the Debt Collection Act. These reports are prepared and submitted to the Department of the Interior's Office of Financial Management for review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



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

2002 Results: The MMS exceeded the government-wide goal by paying invoices 98.4 percent of the time on time.

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



2002 Results: MMS achieved its goal by requiring new vendors and employees to enroll for EFT payments with a 2.5% increase in Vendor EFT payments.

Compliance with Legal and Regulatory Financial Requirements

As of September 30, 2002, the MMS's financial management systems complied substantially with accounting standards applicable to Federal entities, except as discussed in the Independent Auditors' Report.

Minerals Revenue Management implemented its new accounting system November 1, 2001. However, it was operational for one month and brought off-line due to an U.S. District Court Order suspending all Internet accesses within the Department of the Interior. The system remained off-line until March of 2002, resulting in a significant transaction processing backlog. With work-around processes and off-line back-up tracking, all revenue collections and disbursements were accounted for and cash reconciled with the U.S. Treasury.

Federal Managers' Financial Integrity Act (FMFIA)

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

Resolution of Internal Control Weaknesses Reported in 2001 Audited Financial Statements

The following table summarizes actions taken to resolve material weaknesses, reportable conditions, and instances of noncompliance with laws and regulations reported in the Independent Auditors' Report for FY 2001. An unqualified opinion was rendered on two of the bureau's Fiscal Year 2001 financial statements: the Balance Sheet and the Statement of Custodial Activity. All other FY 2001 financial statements were unaudited.

Material Weakness Description	Corrective Action	Target Date	Implemented (Yes/No)
Information Technology Data Security Control Weakness	**Contract for an independent risk assessment of the ABACIS. Obtain approval for the ABACIS Security plan. Test applicable contingency plans.**	**6/30/02**	**Partially**
Year-end Accounts Payable and Accounts Receivable Accrual Process	**Conduct additional training for program staffs. Enhance controls over accounts payable and accounts receivable accrual process.**	**6/30/02**	**Yes**
Compliance with Laws and Regulations	**Prompt Payment Act: Implement additional internal control procedures and provide additional training to the Procurement staffs to ensure that invoices are received timely in accordance with the Prompt Payment Act.**	**6/30/02**	**Yes**
	FFMIA: Develop and implement system specific policies to improvement the authentication process and to minimize network security risks. Implement new MRM Financial System to ensure compliance with U.S. Standard General Ledger posting at the transaction level.	**9/30/02**	**Partially**
	Status: **The MRM Financial System (MRMFS) was implemented November 1, 2001. However, due to a court order shutdown, a significant backlog developed in processing and testing. MRM will develop detailed plans to address the non-compliant issues.**	**9/30/03**	

**Employees of the
Farmington Indian Minerals Office (FIMO)**

FINANCIAL STATEMENTS

Department of the Interior
Minerals Management Service
Consolidated Balance Sheet
As of September 30, 2002 and 2001
(dollars in thousands)

	2002	2001
ASSETS		
Intragovernmental Assets:		
Administrative Fund Balance	**$94,119**	$87,902
Restricted Fund Balance	**1**	-
Fund Balance with Treasury (Note 2)	**94,120**	87,902
Restricted Treasury Securities	**967,273**	948,850
Custodial Treasury Securities	**24,617**	28,410
Investments (Note 3)	**991,890**	977,260
Custodial Accounts Receivable from Treasury	**379,879**	66,783
Administrative Accounts Receivable	**97,085**	35,176
Accounts Receivable, Net (Note 4)	**476,964**	101,959
Advances and Prepayments	**-**	93
Total Intragovernmental Assets	**1,562,974**	1,167,214
Custodial Accounts Receivable	**770,949**	1,220,837
Administrative Accounts Receivable	**374,945**	238,484
Accounts Receivable, Net (Note 4)	**1,145,894**	1,459,321
Property and Equipment, Net of Accumulated Depreciation (Note 5)	**33,307**	28,977
Travel Advances	**29**	23
Total Assets (Note 6)	**$2,742,204**	$2,655,535

Department of the Interior
Minerals Management Service
Consolidated Balance Sheet
As of September 30, 2002 and 2001
(dollars in thousands)

	2002	2001
LIABILITIES		
Intragovernmental Liabilities:		
Custodial Accounts Payable	**$1,150,827**	$1,287,621
Administrative Accounts Payable	**4,077**	3,510
Accounts Payable	**1,154,904**	1,291,131
Accrued Unfunded Annual Leave and Benefits	**1,635**	1,760
Accrued Payroll and Benefits	**1,391**	1,248
Deferred Revenue and Deposit Liabilities	**1,245**	1,246
Total Intragovernmental Liabilities	**1,159,175**	1,295,385
Administrative Accounts Payable	**114,122**	50,775
Accounts Payable	**114,122**	50,775
Contingent Liabilities (Note 7)	**550,000**	-
State Liabilities	**374,919**	238,311
Deferred Revenue and Deposit Liabilities	**24,908**	29,409
Accrued Unfunded Annual Leave and Benefits	**11,082**	10,526
Actuarial Liabilities	**9,560**	7,502
Accrued Payroll and Benefits	**7,450**	6,544
Capital Lease Liability (Note 8)	**21**	-
Total Liabilities (Note 9)	**2,251,237**	1,638,452
Net Position		
Unexpended Appropriations	**6,316**	8,434
Cumulative Results of Operations:		
Administrative Cumulative Results of Operations	**(482,623)**	59,799
EIRF Cumulative Results of Operations	**967,274**	948,850
Total Cumulative Results of Operations	**484,651**	1,008,649
Total Net Position	**490,967**	1,017,083
Total Liabilities and Net Position	**$2,742,204**	$2,655,535

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

Department of the Interior
Minerals Management Service
Consolidated Statement of Net Cost
For the years ended September 30, 2002 and 2001
(dollars in thousands)

	2002	2001 Unaudited
Safety		
Cost	**$239,825**	$78,952
Earned Revenue	**29,332**	38,200
Net Cost	**210,493**	40,752
Environment		
Cost	**226,420**	71,124
Earned Revenue	**27,723**	34,434
Net Cost	**198,697**	36,690
Fair Market Value		
Cost	**128,089**	39,063
Earned Revenue	**15,714**	19,652
Net Cost	**112,375**	19,411
Access to Money		
Cost	**953,342**	1,142,780
Earned Revenue	**17,105**	9,692
Net Cost	**936,237**	1,133,088
Royalty Compliance		
Cost	**219,378**	44,105
Earned Revenue	**27,354**	15,349
Net Cost	**192,024**	28,756
Gov.Works		
Cost	**409,883**	235,077
Earned Revenue	**409,883**	235,433
Net Cost	**-**	(356)
Totals		
Cost (Notes 10 and 12)	**2,176,937**	1,611,101
Earned Revenue (Note 13)	**527,111**	352,760
Net Cost of Operations	**$1,649,826**	$1,258,341

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

Department of the Interior
Minerals Management Service
Consolidated Statement of Changes in Net Position
For the year ended September 30, 2002
(dollars in thousands)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	**$1,008,649**	**$8,434**
Budgetary Financing Sources		
Appropriations Received, General Funds	**-**	**150,667**
Other Adjustments	**-**	**(243)**
Appropriations – Used	**152,542**	**(152,542)**
Non-Exchange Revenue	**18,424**	**-**
MRM Exchange Revenue (Note 14)	**823,841**	**-**
Transfers In/Out without Reimbursement	**6,105**	
Other Financing Sources		
Transfers In/Out without Reimbursement	**(389)**	**-**
Imputed Financing from Costs Absorbed by Others	**125,305**	**-**
Total Financing Sources	**1,125,828**	**(2,118)**
Net Cost of Operations	**(1,649,826)**	**-**
Ending Balance	**$484,651**	**$6,316**

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

Department of the Interior
Minerals Management Service
Statement of Custodial Activity
For the years ended September 30, 2002 and 2001
(dollars in thousands)

	2002	2001
Revenues on Behalf of the Federal Government		
Mineral Lease Revenue		
Rents and Royalties	**$5,445,180**	$9,491,482
Offshore Lease Sales	**884,859**	669,840
Strategic Petroleum Reserve (Note 15)	**262,752**	61,654
Total Revenue	**$6,592,791**	$10,222,976
Disposition of Revenue		
Distribution to Department of the Interior		
National Park Service Conservation Funds	**$1,047,980**	$1,046,493
Minerals Management Service (Note 16)	**794,779**	1,157,049
Bureau of Reclamation	**544,826**	823,929
Bureau of Land Management	**8,270**	7,198
Fish and Wildlife Service	**891**	1,468
Distribution to Other Federal Agencies		
Department of Treasury	**4,138,702**	6,405,104
Department of Energy	**262,752**	61,654
Department of Agriculture	**16,091**	25,410
Department of Commerce	**-**	1,105
Distribution to Indian Tribes and Agencies	**61,338**	107,982
Distribution to States and Others	**30,443**	141,388
Change in Untransferred Revenues (Note 17)	**(313,281)**	444,196
Total Disposition of Revenue	**$6,592,791**	$10,222,976

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

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

	2002
Budgetary Resources:	
Budget Authority:	
Appropriations Received	**$844,006**
Unobligated Balances:	
Beginning of Year	**14,525**
Spending Authority From Offsetting Collections:	
Earned	
Collected	**466,742**
Receivable from Federal Sources	**61,898**
Change in Unfilled Customer Orders	
Advance Received	**(720)**
Without Advance from Federal Sources	**89,263**
Recoveries of Prior Year Obligations	**10,586**
Permanently not Available	**(243)**
Total Budgetary Resources	**$1,486,057**
Status of Budgetary Resources:	
Obligations Incurred:	
Direct (Category B)	**$846,578**
Reimbursable (Category B)	**629,641**
Total Obligations Incurred (Note 18)	**1,476,219**
Unobligated Balances:	
Apportioned	**7,657**
Unobligated Balance not Available	**2,181**
Total Status of Budgetary Resources	**$1,486,057**
Relationship of Obligations to Outlays:	
Obligations Incurred	**$1,476,219**
Obligated Balance, Net, Beginning of Year	**73,376**
Obligated Balance, Net, End of Year:	
Accounts Receivable	**97,075**
Unfilled Customer Orders from Federal Sources	**209,447**
Undelivered Orders	**(263,764)**
Accounts Payable	**(127,028)**
Less: Spending Authority Adjustments	**(161,747)**
Outlays:	
Disbursements	**1,303,578**
Collections	**(466,021)**
Net Outlays before Offsetting Receipts	**837,557**
Less: Offsetting Receipts	**(867,646)**
Net Outlays	**($30,089)**

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

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

		2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations Incurred	**$1,476,219**	
Less: Spending Authority from Offsetting Collections and Recoveries	**(627,769)**	
Obligations Net of Offsetting Collections and Adjustments	**848,450**	
Less: Offsetting Receipts	**(867,646)**	
Net Obligations	**(19,196)**	
Other Resources:		
Transfers In/Out without Reimbursement	**(389)**	
Imputed Financing from Costs Absorbed by Others	**125,305**	
Net Other Resources Used to Finance Activities	**124,916**	
Total Resources Used to Finance Activities		**$105,720**
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not Yet Provided	**(8,313)**	
Resources that Fund Expenses Recognized in Prior Periods	**(16)**	
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations		
Offsetting Receipts not Part of the Net Cost of Operations	**867,646**	
Resources that Finance the Acquisition of Assets	**(8,974)**	
Total Resources Used to Finance Items not Part of the Net Cost of Operations:		**850,343**
Total Resources Used to Finance the Net Cost of Operations		**956,063**
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	**557**	
Change in Unfunded Liabilities and Other	**688,562**	
Total Components of Net Cost of Operations that will Require or Generate Resources in the Future Period		**689,119**
Components not Requiring or Generating Resources:		
Depreciation and Amortization	**4,644**	
Total Components of Net Cost of Operations that will not Require or Generate Resources		**4,644**
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period		**693,763**
Net Cost of Operations		**$1,649,826**

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

Whaling off the coast of Alaska

MINERALS MANAGEMENT SERVICE
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2002 and 2001

Note 1.1 Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position, budgetary resources, and custodial activities of the Minerals Management Service (MMS), as required by the Chief Financial Officers Act of 1990. The financial statements have been prepared from the accounting records of MMS in accordance with accounting principles generally accepted in the United States of America (GAAP) using guidance issued by the Federal Accounting Standards Advisory Board (FASAB), and the Office of Management and Budget (OMB). Significant MMS accounting policies are summarized in this note.

B. Reporting Entity

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

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

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

C. Basis of Accounting

MMS maintains its accounting records on both an accrual accounting basis and a budgetary accounting basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

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

D. Other Financing Sources and Revenues

The primary financing sources for Minerals Management Service operations come from its annual Congressional appropriation and its authority to retain certain receipts resulting from its activities. These funds are used for operating and capital expenditures of MMS. Additional amounts are obtained through reimbursements for services performed for other Federal agencies under the Economy Act.

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

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

MMS is authorized to retain a portion of the rental income collected as a part of the custodial activity provided by the Minerals Revenue Management Program to fund its operating costs.

E. Fund Balance With Treasury

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

F. Accounts Receivable

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

G. Property and Equipment

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

In FY 2002, MMS moved the new MRM accounting system into production and began amortization. The Internal Use Software was added for the Royalty In Kind System (RIK) in FY 2002. It will not be put into production until FY 2003; therefore amortization was not recorded in FY 2002.

H. Liabilities

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

The Department of Labor (DOL) administers the Federal Employees Compensation Act (FECA) which provides workers' compensation benefits to Federal employees. There are two types of liabilities related to workers' compensation. The unfunded accrued FECA liability represents MMS Workers Compensation claims paid by the DOL for Workers' Compensation which have not yet been reimbursed by MMS. The unfunded actuarial FECA liability represents an estimate of future workers' compensation.

I. Accrued Unfunded Annual Leave

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

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

J. Contingent Liabilities

Contingent liabilities are recorded in the accounting records when an event potentially leading to the recognition of a liability is probable, and a reasonable estimate of the scope of the potential liability is available.

K. Retirement Plans

MMS employees participate in one of two retirement systems, the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). Employees hired prior to January 1, 1984 could elect to join FERS or continue to participate in CSRS. Employees hired after December 31, 1983 are automatically covered by FERS and social security. MMS makes matching contributions equal to seven percent of basic pay for CSRS employees. FERS offers a savings plan to which MMS automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. For employees in FERS, MMS also contributes the employer's matching share for Social Security.

L. Income Taxes

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

M. Use of Estimates

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

N. Net Position

Net position consists of unexpended appropriations, cumulative results of operations, and restricted equity. Unexpended appropriations include available and unavailable unobligated balances as well as undelivered orders. Cumulative results of operations include the difference between revenues and expenses, the net amount of transfers of assets in and out without reimbursement, and donations (all of these include balances since the inception of the fund). Restricted equity is comprised of the balance in the Environmental Improvement and Restoration Fund. As of September 30, 2002 and September 30, 2001, there are no estimated obligations related to canceled appropriations.

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

A. MRM Financing Sources and Revenues

MRM collects and accrues for bonuses, rents, royalties and other receipts from Federal Government and Indian leases, and distributes all proceeds to the Treasury, other Federal Agencies, States, Indian Tribes, and Indian Allottees, in accordance with legislated allocation formulas.

Starting in FY 2001, the accounting policy for reporting was changed to reclassify refunds and/or revenues not belonging to the Federal Government as contra revenues to more accurately account for the custodial revenues and to track offsetting disbursements.

Royalty-in-Kind (RIK) Program

The Federal Government, under the provisions of the Mineral Lands Leasing Act of 1920 and the Outer Continental Shelf Lands Act (OCSLA) of 1953, may take part or all of its oil and gas royalties in-kind (a volume of the commodity) as opposed to in value (cash). MMS may either transfer the volume of oil or gas commodity taken in kind to Federal agencies for internal use or sell the commodity on the open market at fair market value to generate revenue. Revenues received from the sale of royalty oil or gas in these financial statements are referred to as royalties.

MRM assists the administration's initiative to fill the Strategic Petroleum Reserve. MMS transfers to the Department of Energy royalty oil taken in kind from Federal leases in the Gulf of Mexico. During FY 2002, such activity occurred in April through September, totaling approximately 11.2 million barrels. In FY 2001, MMS transferred approximately 2.4 million barrels to the Department of Energy for use in adding to the reserve.

Environmental Improvement and Restoration Fund (EIRF)

The Environmental Improvement and Restoration Fund (EIRF) was established pursuant to Title 4 of the Department of the Interior and Related Agencies Appropriations Act for FY 1998. Half of the principal and interest from the distribution of the Alaska Escrow Fund was deposited into EIRF during FY 2000. During FY 2002 and 2001, MRM deposited to the EIRF interest earned from investments of the EIRF principal. Congress has permanently appropriated and MRM has transferred 20% of the prior fiscal year interest earned by the EIRF to the Department of Commerce. The remaining 80% will remain in the fund to earn interest and may be appropriated by Congress to certain other agencies, as provided by the law. No assets are available to the Department of the Interior unless appropriated by Congress.

B. Distributions of Revenues

Federal Revenues: Distributions are based on the Mineral Lands Leasing Act of 1920, 30 USC

191 as amended, the Federal Oil and Gas Royalty Management Act of 1982 (PL 97-451, 96 Stat. 2447, 30 USC 1701), the 1986 OCS Lands Act amendments of 1985 (PL 99-272), and subsequent legislation and lease terms. The custodial activity presentation for federal revenues is segregated by distributions to entities internal and external to MMS.

Revenues distributed to entities within the Department of the Interior (DOI) include the Bureau of Reclamation (BOR), Bureau of Land Management (BLM), National Park Service (NPS), Fish and Wildlife Service (FWS) and MMS.

Revenues distributed to other Federal entities not in DOI include the Department of the Treasury, Department of Commerce, USDA Forest Service, and Department of Energy. Revenues transferred to Treasury are deposited to Treasury's General Fund. Revenues distributed to MMS are subsequently appropriated and/or made available for program expenditures and disbursements approved by Congress. Monies collected in MMS administrative appropriated funds are recorded as exchange revenues and subsequently used for operational purposes.

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

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

C. Fund Balance With Treasury

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

Previously, the undistributed custodial clearing account fund balance transferred to the General Fund of the Treasury at the end of each fiscal year was shown on the MMS Balance Sheet. Commencing in FY 2001, in lieu of reporting the transferred amount as part of the fund balance, an accounts receivable is recognized for the estimated amount that is subsequently withdrawn from Treasury for redistribution to the other major recipients – MMS for payment to the States and BOR.

D. Accounts Receivable

The financial statements reflect accounts receivable accrual adjustments. These adjustments were made to conform to GAAP for presentation purposes. Amounts due from the public for royalty revenues are stated net of an allowance amount. The custodial receivables represent royalty invoices, deferred bonus amounts, and accumulated interest. The oil and gas companies provide sureties to cover the majority of the receivables for audit bills, but not for most RIK invoices. The current surety value, excluding RIK, is $279 million and $243 million for receivables as of September 30, 2002 and September 30, 2001, respectively. The invoice value and potential interest on the invoices do not include principal and interest on contract settlement invoices for which sureties are not required.

For FY 2002, an analysis of the last five years of collections, current events, special occurrences, and distributions was used to determine the year-end accrual method of calculating the anticipated revenues and distributions for the September production of gas and oil including royalties-in-kind that are due in October.

An allowance for estimated uncollectible amounts was recognized to reduce the gross amount of receivables to its realizable value. The allowance estimate for royalty payments was based on historical experience in collecting accounts receivable. The method of calculating this estimate was based on the rate of collections to revenues. A percent was applied to the FY 2002 Accounts Receivable balance recognized from accounting transactions.

E. Investments of Custodial Assets

Investments represent Federal Government securities and are reported at cost net of amortized premiums or discounts. MMS has limited investment authority based on two categories: (1) Restricted and (2) Custodial:

Restricted Investments

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

Custodial Investments

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

F. Liabilities

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

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

G. Other Accrued Liabilities

MMS makes payments to States according to the Mineral Lands Leasing Act of 1920, 30 USC 191 as amended, the Federal Oil and Gas Royalty Management Act of 1982 (PL 97-451, 96 Stat. 2447, 30 USC 1701), and PL 99-272 from the 1986 OCS Lands Act amendments of 1985. The liabilities to States for accrued minerals revenue is shown as unfunded because budgetary resources, which are authorized by the Act as permanent indefinite appropriations, are based on actual collections (appropriated revenues). In FY 2002 and 2001, the accrued unfunded liabilities associated with the accrual of expenses for the payments to the States are reported on the Consolidated Balance Sheet.

Note 2. Fund Balance with Treasury

A summary of the fund balance with treasury by fund type is listed in the first table below. The appropriated funds consist of funds for the operation of MMS such as salaries and expenses, and computer acquisition. The trust funds consist of oil spill liability funds. Refer to Footnote 1.2A for information on the EIRF funds. The custodial funds represent royalty collections received by MMS and held as custodian, until disbursed to recipients. The second table shows the same information by status instead of fund type.

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

	2002	2001
General		
Appropriated	$87,859	$82,710
Trust	6,260	5,192
Restricted		
Special Expenditure Funds (EIRF)	1	-
Total Fund Balance with Treasury	**$94,120**	**$87,902**

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

	2002	2001
Unobligated Balance		
Available – Budget Authority	$ 7,657	$12,767
Available - Investment	1	-
Unavailable	2,193	1,863
Obligated Balance not yet Disbursed	84,269	73,272
Total Fund Balance with Treasury	**$94,120**	**$87,902**

Note 3. Investments, Net

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

As of September 30, 2002
(dollars in thousands)

Description	Par Value	Amortization Method	Unamortized Discount (Premium)	Investments, Net	Market Value Disclosure
Non-Marketable market-based Treasury Securities					
Restricted	$973,557	Straight Line	($6,284)	$967,273	$967,758
Custodial	24,644	Straight Line	(27)	24,617	24,619
Total Treasury Securities	**$998,201**		**($6,311)**	**$991,890**	**$992,377**

As of September 30, 2001
(dollars in thousands)

Description	Par Value	Amortization Method	Unamortized Discount (Premium)	Investments, Net	Market Value Disclosure
Non-Marketable market-based Treasury Securities					
Restricted	$961,779	Straight Line	($12,929)	$948,850	$952,482
Custodial	28,451	Straight Line	(41)	28,410	28,410
Total Treasury Securities	**$990,230**		**($12,970)**	**$977,260**	**$980,892**

Note 4. Accounts Receivable

The following table segregates the accounts receivable balances between the Minerals Management Service's administrative and Minerals Revenue Management directorate's custodial receivables. Accounts receivable relating to general operations of the bureau consist primarily of amounts due to MMS from other agencies in connection with various interagency agreements, and refunds due from MMS vendors and/or employees. Interest receivables are included as part of the custodial receivables in the amount of $152 million and $155 million as of September 30, 2002 and September 30, 2001, respectively. Refer to Footnote 1.2C for information on Custodial Receivables from Federal Agencies.

Net Accounts Receivable due to MMS
As of September 30,
(dollars in thousands)

Accounts Receivable	Current	1-180 days	181-365 days	Over 1 year	Total Accounts Receivable	Allowance Beginning Balance	Allowance Reductions/ Collections	Allow. Ending Balance	2002
Due From Public									
Custodial	$757,792	$254	$2,977	$310,874	**$1,071,897**	($270,281)	($30,667)	**($300,948)**	**$ 770,949**
Receivables for States	374,919	-	-	-	**374,919**	-	-	-	**374,919**
Administrative	18	-	2	6	**26**	-	-	-	**26**
Due From Federal Agencies									
Custodial	379,879	-	-	-	**379,879**	-	-	-	**379,879**
Administrative	97,085	-	-	-	**97,085**	-	-	-	**97,085**
Net Receivables	**$1,609,693**	**$254**	**$2,979**	**$310,880**	**$1,923,806**	**($270,281)**	**($30,667)**	**($300,948)**	**$1,622,858**
Accounts Receivable	***(a)* Current**	***(a)* 1-180 days**	***(a)* 181-365 days**	***(a)* Over 1 year**	**Total Accounts Receivable**	***(a)* Allowance Beginning Balance**	***(a)* Allowance Reductions/ Collections**	**Allow. Ending Balance**	**2001**
Due From Public									
Custodial	$1,342,531	$20,066	$16,542	$111,979	**$1,491,118**	($297,288)	$27,007	**($270,281)**	**$1,220,837**
Receivables for States	238,311	-	-	-	**238,311**	-	-	-	**238,311**
Administrative	173	-	-	-	**173**	-	-	-	**173**
Due From Federal Agencies									
Custodial	66,783	-	-	-	**66,783**	-	-	-	**66,783**
Administrative	35,176	-	-	-	**35,176**	-	-	-	**35,176**
Net Receivables	**$1,682,974**	**$20,066**	**$16,542**	**$111,979**	**$1,831,561**	**($297,288)**	**$27,007**	**($270,281)**	**$1,561,280**

(a) = Unaudited

Note 5. Property and Equipment

MMS property and equipment categories, with corresponding accumulated depreciation, are shown in the table below. The Internal Use Software for the MRM Accounting System was put into production November of 2001. The Internal Use Software was added for the Royalty In Kind System (RIK), but will not be put into production until FY 2003. Therefore, no amortization has been accumulated for the RIK System. Depreciation expense amounted to approximately $4.6 million, FY 2002 and $8.4 million, FY 2001. Depreciation is recorded using the straight-line method based on the useful lives ranging from 3 to 10 years. The useful life for equipment and vehicles is 3 to 10 years, and Internal Use Software in Service is 10 years.

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

Description	2001	Additions	Disposals	2002
Equipment and Vehicles	$22,030	$1,393	($2,856)	$20,567
Less: Accumulated Depreciation, Equipment and Vehicles	(15,272)	(2,494)	2,519	(15,247)
Capital Leases	-	75	-	75
Less: Accumulated Depreciation, Capital Leases	-	(36)	-	(36)
Internal Use Software in Service	-	23,067	-	23,067
Less: Accumulated Depreciation, Internal Use Software in Service	-	(2,114)	-	(2,114)
Internal Use Software in Development	22,219	(15,224)	-	6,995
Net Book Value	**$28,977**	**$4,667**	**($337)**	**$33,307**

Note 6. Assets Analysis

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

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

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

Description	Entity	Restricted	Non-Entity	2001
Intragovernmental Assets				
Fund Balance with Treasury	$ 87,902	$ -	$ -	$ 87,902
Treasury Securities	-	948,850	28,410	977,260
Accounts Receivable, Net	35,176	-	66,783	101,959
Prepayments	93	-	-	93
Total Intragovernmental Assets	**$123,171**	**$948,850**	**$ 95,193**	**$1,167,214**
Accounts Receivable, Net	238,484	-	1,220,837	1,459,321
Travel Advances	23	-	-	23
Property & Equipment, Net	28,977	-	-	28,977
Total Public Assets	**$267,484**	**-**	**$1,220,837**	**$1,488,321**
Total Assets	**$390,655**	**$948,850**	**$1,316,030**	**$2,655,535**

Note 7. Contingent Liabilities

The MMS is party to various administrative proceedings, legal actions, environmental suits, and claims that may eventually result in the payment of substantial monetary claims to third parties. The claims enumerated and submitted to MMS by the Office of the Solicitor deemed as probable of loss and where the amount of potential liability has been estimated have been reported in the financial statements. The potential liability claims deemed to be probable of loss have been estimated between $400 million and $2,000 million. It is the Office of the Solicitors opinion that any amounts due will be paid from the Department of the Justice Judgment Fund. Sufficient information is not currently available to determine if the ultimate resolution of any other proceedings, actions and claims will materially affect the financial position or net cost of operations of MMS.

Note 8. Leases

Capital Leases:

MMS has two capital leases with Oce USA, Inc. for copiers which transfer ownership of the property to MMS at the end of the lease term. The value of these leases is $75 thousand. The table below shows the future payments expected for these lease agreements.

Future Payments Due
As of September 30, 2002
(dollars in thousands)

Capital Leases:	
Fiscal Year	**Copiers**
2003	$19
2004	19
Total Future Lease Payments	38
Less: Imputed Interest	(17)
Net Capital Lease Liability	**$21**
Lease Liability Covered by Budgetary Resources	**$21**

Operating Leases:

MMS has several General Services Administration (GSA) lease agreements for office space. The leases are subject to appropriations becoming available and have a 180-day cancellation clause. The table below shows the future payments expected for these GSA lease agreements. MMS also has some small equipment leases for copiers that are not disclosed.

Future Payments Due
As of September 30, 2002
(dollars in thousands)

Operating Leases:	
Fiscal Year	**GSA Space Leases**
2003	$10,735
2004	9,311
2005	7,753
2006	7,707
2007	7,769
After 5 Years	14,123
Total Future Lease Payments	**$57,398**

Note 9. Liabilities

Liabilities shown below include all liabilities, both funded and unfunded, that are due to the Public and other Federal Entities. Funded liabilities are liabilities covered by budgetary resources; likewise, unfunded liabilities are liabilities not covered by budgetary resources. The only non-current liabilities are the FECA Actuarial Liabilities, Accrued Annual Leave, and $981 thousand of the Accrued FECA Liabilities.

LIABILITIES
As of September 30,
(dollars in thousands)

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	2002
Intragovernmental:			
Accounts Payable	$ 4,077	$ -	$ 4,077
Accrued Payroll and Benefits	1,391	-	1,391
Custodial Liabilities	-	1,150,827	1,150,827
Unfunded Accrued FECA	-	1,635	1,635
Advances from Others	1,245	-	1,245
Total Intragovernmental Liabilities	**$ 6,713**	**$1,152,462**	**$1,159,175**
Public			
Accounts Payable	114,122	-	114,122
Accrued Salaries and Wages	7,450	-	7,450
Unfunded Actuarial FECA	-	9,560	9,560
Unfunded Accrued Annual Leave	-	11,082	11,082
Deposit Liabilities	216	24,629	24,845
Capital Lease Liabilities	21	-	21
Contingent Liabilities (Note 7)	-	550,000	550,000
State Liabilities	-	374,919	374,919
Advances from Others	63	-	63
Total Public Liabilities	**$121,872**	**$ 970,190**	**$1,092,062**
Total Liabilities	**$128,585**	**$2,122,652**	**$2,251,237**

	Covered by Budgetary Resources	Not Covered by Budgetary Resources	2001
Intragovernmental:			
Accounts Payable	$ 3,510	$ -	$ 3,510
Accrued Payroll and Benefits	1,248	-	1,248
Custodial Liabilities	-	1,287,621	1,287,621
Unfunded Accrued FECA	-	1,760	1,760
Advances from Others	1,246	-	1,246
Total Intragovernmental Liabilities	**$ 6,004**	**$1,289,381**	**$1,295,385**
Public			
Accounts Payable	50,775	-	50,775
Accrued Salaries and Wages	6,544	-	6,544
Unfunded Actuarial FECA	-	7,502	7,502
Unfunded Accrued Annual Leave	-	10,526	10,526
Deposit Liabilities	217	28,410	28,627
State Liabilities	-	238,311	238,311
Advances from Others	782	-	782
Total Public Liabilities	**$58,318**	**$ 284,749**	**$ 343,067**
Total Liabilities	**$64,322**	**$1,574,130**	**$1,638,452**

Revenue is considered deferred until it is earned. Federal Agency deferred revenue represents advances from Federal agencies for anticipated obligations. Public deferred revenue primarily consists of bond forfeiture collections. MMS is authorized to use forfeited bonds of an Outer Continental Shelf lessee who did not fulfill the requirements of the lease. The funds are to be used to cover the cost of improvement, protection, or rehabilitation work arising from the forfeiture.

Note 10. Net Cost by Responsibility Segment

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

	Offshore Minerals Management	Mineral Revenue Management	GovWorks	2002
Safety				
Cost – Services and Goods Provided to the Public	$237,750	$ -	$ -	$237,750
Revenue from the Public	27,266	-	-	27,266
Net Cost – Federal Programs and Sales to the Public	210,484	-	-	210,484
Cost – Sales to other Federal Agencies	2,075	-	-	2,075
Revenue – Federal Agencies	2,066	-	-	2,066
Net Cost – Sales to other Federal Agencies	9	-	-	9
Net Cost	210,493	-	-	210,493
Environment				
Cost – Services and Goods Provided to the Public	224,499	-	-	224,499
Revenue from the Public	25,811	-	-	25,811
Net Cost – Federal Programs and Sales to the Public	198,688	-	-	198,688
Cost – Sales to other Federal Agencies	1,921	-	-	1,921
Revenue – Federal Agencies	1,912	-	-	1,912
Net Cost – Sales to other Federal Agencies	9	-	-	9
Net Cost	198,697	-	-	198,697
Fair Market Value				
Cost – Services and Goods Provided to the Public	127,032	-	-	127,032
Revenue from the Public	14,662	-	-	14,662
Net Cost – Federal Programs and Sales to the Public	112,370	-	-	112,370
Cost – Sales to other Federal Agencies	1,057	-	-	1,057
Revenue – Federal Agencies	1,052	-	-	1,052
Net Cost – Sales to other Federal Agencies	5	-	-	5
Net Cost	112,375	-	-	112,375
Access to Money				
Cost – Services and Goods Provided to the Public	-	952,298	-	952,298
Revenue from the Public	-	16,067	-	16,067
Net Cost – Federal Programs and Sales to the Public	-	936,231	-	936,231
Cost – Sales to other Federal Agencies	-	1,044	-	1,044
Revenue – Federal Agencies	-	1,038	-	1,038
Net Cost – Sales to other Federal Agencies	-	6	-	6
Net Cost	-	936,237	-	936,237
Royalty Compliance				
Cost – Services and Goods Provided to the Public	-	217,595	-	217,595
Revenue from the Public	-	25,579	-	25,579
Net Cost – Federal Programs and Sales to the Public	-	192,016	-	192,016
Cost – Sales to other Federal Agencies	-	1,783	-	1,783
Revenue – Federal Agencies	-	1,775	-	1,775
Net Cost – Sales to other Federal Agencies	-	8	-	8
Net Cost	-	192,024	-	192,024
GovWorks				
Cost – Services and Goods Provided to the Public	-	-	-	-
Revenue from the Public	-	-	-	-
Net Cost – Federal Programs and Sales to the Public	-	-	-	-
Cost – Sales to other Federal Agencies	-	-	409,883	409,883

Revenue – Federal Agencies	-	-	409,883	409,883
Net Cost – Sales to other Federal Agencies	-	-	-	-
Net Cost	-	-	-	-

Totals				
Cost – Services and Goods Provided to the Public	589,281	1,169,893	-	1,759,174
Revenue from the Public	67,739	41,646	-	109,385
Net Cost – Federal Programs and Sales to the Public	521,542	1,128,247	-	1,649,789
Cost – Sales to other Federal Agencies	5,053	2,827	409,883	417,763
Revenue – Federal Agencies	5,030	2,813	409,883	417,726
Net Cost – Sales to other Federal Agencies	23	14	-	37
Net Cost of Operations	$521,565	$1,128,261	$-	$1,649,826

Note 12. Program Costs

Program costs are presented in the table below by major category of expenses, segregated by funded and unfunded budgetary resource availability. Budgetary resources funding expenses are derived from appropriations and from reimbursable revenues earned from other Government agencies under The Economy Act. The unfunded expenses will be disbursed pending future funding of budgetary resources or, as in the case of depreciation, the capitalized property was funded at the time of acquisition. The Payments to States, $687 million, and the Accrued Expenses to States, $137 million, equate to the total Payments to States, $824 million for FY 2002. For FY 2001, the Payments to States, $1,050 million, and the Accrued Expenses to States, $67 million, equate to the total Payments to States, $1,117 million. As discussed in Note 7, fiscal year 2002 future funded expenses included accrued contingent liabilities of $550 million.

As reflected in the Imputed Expense line on the table below, the Treasury Judgment Fund funded the settlement of the contingent liability reported in FY 2001. President Bush committed the federal government to buy back the oil and gas leases in the Destin Dome area offshore from Florida.

Fiscal Years 2002 and 2001
(dollars in thousands)

Description	2002	2001 Unaudited
Funded Expenses:		
Payments to States	$687,234	$1,049,639
Personnel Compensation	143,254	110,021
Contractual Services	499,252	338,275
Rent, Communication, and Utilities	14,142	14,696
Travel and Transportation	4,137	4,354
Supplies and Materials	2,417	2,126
Printing and Reproduction	726	2,099
Acquisition of Non-Capitalized Property	5,953	1,882
Bad Debt Expense	17	12
Other Funded Expenses	442	355
Total of Funded Expenses	**$1,357,574**	**$1,523,459**
Unfunded Expenses:		
Imputed Expenses	125,305	165,379
Depreciation	4,644	8,353
Accrued Expenses to States	136,608	66,990
Future Funded Expenses	550,432	(155,505)
Net Loss on Disposition of Assets	332	852
Other Unfunded Expenses	2,042	1,573
Total of Unfunded Expenses	**$819,363**	**$ 87,642**
Total Program Expenses	**$2,176,937**	**$1,611,101**

Note 13. Exchange Revenues

The Sales of Goods and Services in the table below represents reimbursable revenues from customers recognized for services provided. Other revenues represent MRM federal revenues distributed to MMS for operational purposes. For further information, see Note 1.1D.

Fiscal Years 2002 and 2001
(dollars in thousands)

Description	2002	2001 Unaudited
Revenues:		
Sales of Goods and Services to the Public	$ 1,022	$ 755
Sales of Goods and Services to the Franchise Fund	401,417	235,352
Sales of Goods and Services to Other Federal Agencies	16,308	3,725
Other Revenues:		
Other Revenues – Public	6,069	5,518
As appropriated by Congress	102,295	107,410
Total Revenues	**$527,111**	**$352,760**

Note 14. Royalty Exchange Revenues

In FY 2002 and 2001, the royalty exchange revenues that are distributed to Federal agencies are reported by the receiving entity on the Statement of Changes in Net Position in accordance with the FASAB standards. MMS has received $687 million, FY 2002, and $1,050 million, FY 2001 in cash revenues and $137 million, FY 2002, and $67 million, FY 2001, in accrued revenues under permanent indefinite appropriations expensed to the States. See Notes 11 and 12 for additional information regarding the expenses to the States.

Note 15. Transfers of Royalty Oil to Department of Energy

During FY 2002 and FY 2001, MMS transferred to the Department of Energy (DOE) approximately 11.2 million and 2.4 million barrels of oil, respectively, drawn from Federal leases within the Gulf of Mexico. The purpose of these transfers was to refill selected Strategic Petroleum Reserve (SPR) locations. In FY 2002, MMS valued the oil based on the actual volumes reported on pipeline statements applied to commodity prices at onshore market centers less actual monthly value differences between offshore and onshore market centers that were bid by the successful bidders on the Royalty-in-Kind volumes. However, for August and September, the volumes were based on nominations as the actuals were not available. September prices were estimated using August actual pricing. In FY 2001, the DOE placed a value of $61.7 million on the oil for purposes of accounting for receipt of this asset. MMS has no cost basis for this oil and received no revenues for it. For the purpose of reflecting this activity in the Statement of Custodial Activity, MMS utilized the DOE valuation. MMS can provide no opinion on the methodology used by DOE for valuation of this oil. A significant amount of the oil was provided to non-governmental entities, to be replaced at future dates, adding to the difficulty of any valuation.

Note 16. Custodial Distributions to MMS

In FY 2002 and FY 2001 the federal revenues subsequently paid to the States have been changed to show the collections for others to MMS and expensed to the States under MMS Permanent Expenditure Appropriation set up by law for this purpose. The amount distributed as Revenues to Fund Operations is legislated by Congress as part of MMS' annual appropriation.

Fiscal Years 2002 and 2001
(dollars in thousands)

Distributions to MMS	2002	2001
Payments to States	$687,234	$1,049,639
RIK for SPR Transportation	5,250	-
Revenues to Fund Operations	102,295	107,410
Total Distributions	$794,779	$1,157,049

Note 17. Change in Untransferred Revenues

The change in Untransferred Revenues was determined based on the outstanding accruals in the FY 2002 and FY 2001 consolidated balance sheets.

Note 18. Apportionment Categories of Obligations Incurred

The amounts of direct and reimbursable obligations, incurred at MMS, are apportioned under Category B. The obligation amounts match the Statement of Budgetary Resources, but have a difference in FY 2002 of $1 million to the SF-133 bureau total. This difference is attributable to the fact that MMS reports a portion of 14X5003 on FACTSII (SF-133) for Bureau of Land Management (BLM). BLM reports their portion of 14X5003 on their Statement of Budgetary Resources. The following table reflects direct and reimbursable obligations.

Fiscal Year 2002
(dollars in thousands)

Description	2002
Direct Obligations	$ 846,578
Reimbursable Obligations	629,641
Total Obligations	**$1,476,219**

Note 19. Permanent Indefinite Appropriations

MMS expenses to States payments under three permanent, indefinite appropriations:

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

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

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

Note 20. Differences Between the Statement of Budgetary Resources and the Budget of the United States Government

Since the Budget of the United States Government will not be available until after February 4, 2003, any differences between the Statement of Budgetary Resources and the Budget of the United States Government cannot be identified. The Budget of the United States Government will be available on www.whitehouse.gov/omb/budget.

Note 21. Subsequent Event

The Department of the Interior (Interior) transferred part of the Interior Franchise Fund from Interior's Departmental Offices to MMS commencing October 1, 2002. Consequently, effective October 1, 2002, Interior Franchise Fund will be a component of MMS rather than Departmental Offices. MMS will provide the products and services for the existing customer agreements and future customer agreements through the Interior Franchise Fund. As a result of the transfer, MMS's assets and liabilities increased by approximately $420 million, primarily a result of an increase in Fund Balance With Treasury, off-set by a corresponding increase in liabilities for advances received. This transfer will have an immaterial effect on MMS's net cost of operations and net position.

Environmental Study
Photo by: Gregory Boland

Required Supplemental Information

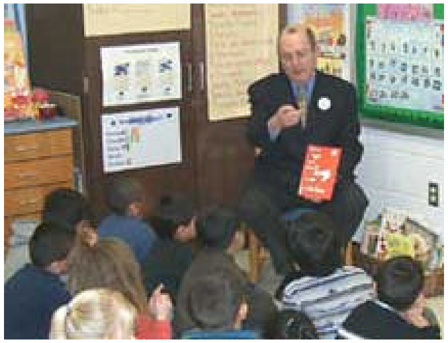
(UNAUDITED, SEE AUDITORS' REPORT)

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

	Royalty and Offshore Minerals Management	Mineral Leasing	Oil Spill Research	Other	2002
Budgetary Resources:					
Budget Authority:					
Appropriations Received	$150,668	$683,510	$6,105	$3,723	**$844,006**
Unobligated Balance:					
Beginning of Year	13,442	-	1,083	-	**14,525**
Spending Authority from Offsetting Collections:					
Earned					
Collected	466,223	-	519	-	**466,742**
Receivable from Federal Sources	61,868	-	30	-	**61,898**
Change in Unfilled Customer Orders					
Advance Received	(667)	-	(53)	-	**(720)**
Without Advance from Federal Sources	89,280	-	(17)	-	**89,263**
Recoveries of Prior Year Obligations	10,563	-	23	-	**10,586**
Permanently Not Available	(243)	-	-	-	**(243)**
Total Budgetary Resources	$791,134	$683,510	$7,690	$3,723	**$1,486,057**
Status of Budgetary Resources:					
Obligations Incurred:					
Direct (Category B)	152,159	683,510	7,186	3,723	**846,578**
Reimbursable (Category B)	629,146	-	495	-	**629,641**
Total Obligations Incurred	781,305	683,510	7,681	3,723	**1,476,219**
Unobligated Balance:					
Apportioned	7,648	-	9	-	**7,657**
Unobligated Balance not Available	2,181	-	-	-	**2,181**
Total Status of Budgetary Resources	$791,134	$683,510	$7,690	$3,723	**$1,486,057**

	Royalty and Offshore Minerals Management	Mineral Leasing	Oil Spill Research	Other	2002
Relationship of Obligations to Outlays:					
Obligations Incurred	781,305	683,510	7,681	3,723	**1,476,219**
Obligated Balance, Net, Beginning of Year	69,267	-	4,109	-	**73,376**
Obligated Balance, Net, End of Year:					
Accounts Receivable	97,045	-	30	-	**97,075**
Unfilled Customer Orders from Federal Sources	209,447	-	-	-	**209,447**
Undelivered Orders	(258,808)	-	(4,956)	-	**(263,764)**
Accounts Payable	(125,703)	-	(1,325)	-	**(127,028)**
Less: Spending Authority Adjustments	(161,711)	-	(36)	-	**(161,747)**
Outlays					
Disbursements	610,842	683,510	5,503	3,723	**1,303,578**
Collections	(465,556)	-	(465)	-	**(466,021)**
Net Outlays before Offsetting Receipts	145,286	683,510	5,038	3,723	**837,557**
Less: Offsetting Receipts	-	(683,510)	-	(184,136)	**(867,646)**
Net Outlays	$145,286	$-	$5,038	($180,413)	**($30,089)**

Read Across America Day



MMS Associate Director Bob Brown read "*Green Eggs and Ham*" to students at Herndon Elementary School in celebration of the 6th annual Read Across America Day. More than 40 million students around the Nation participated in the event, which is celebrated March 3rd, on the anniversary of Dr. Seuss's birthday. MMS is partners in education with Herndon Elementary School, which is located in Herndon, VA.

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Other Supplementary Information

(SEE AUDITORS' REPORT)

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

	Minerals Revenue Management	Offshore Minerals Management	GovWorks	Custodial	Environmental	2002
ASSETS						
Intragovernmental Assets:						
Administrative Fund Balance	$34,394	$59,016	$709	$-	$-	**94,119**
Restricted Fund Balance	-	-	-	-	1	**1**
Fund Balance with Treasury	34,394	59,016	709	-	1	**94,120**
Restricted Treasury Securities	-	-	-	-	967,273	**967,273**
Custodial Treasury Securities	-	-	-	24,617	-	**24,617**
Investments	-	-	-	24,617	967,273	**991,890**
Custodial Accounts Receivable from Treasury	-	-	-	379,879	-	**379,879**
Administrative Accounts Receivable	180	359	96,546	-	-	**97,085**
Accounts Receivable, Net	180	359	96,546	379,879	-	**476,964**
Total Intragovernmental Assets	34,574	59,375	97,255	404,496	967,274	**1,562,974**
Custodial Accounts Receivable	-	-	-	770,949	-	**770,949**
Administrative Accounts Receivable	374,928	16	1	-	-	**374,945**
Accounts Receivable, Net	374,928	16	1	770,949	-	**1,145,894**
Property & Equipment, Net of Accumulated Depreciation	29,834	3,473	-	-	-	**33,307**
Advances and Prepayments	11	18	-	-	-	**29**
Total Assets	$439,347	$62,882	$97,256	$1,175,445	$967,274	**$2,742,204**

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

	Minerals Revenue Management	Offshore Minerals Management	GovWorks	Custodial	Environmental	2002
LIABILITIES						
Intragovernmental Liabilities:						
Custodial Accounts Payable	$ -	$ -	$ -	$1,150,827	$ -	**$1,150,827**
Administrative Accounts Payable	1,267	2,198	612	-	-	**4,077**
Accounts Payable	1,267	2,198	612	1,150,827	-	**1,154,904**
Accrued Un funded Annual Leave and Benefits	575	1,060	-	-	-	**1,635**
Accrued Payroll and Benefits	571	790	30	-	-	**1,391**
Deferred Revenue and Deposit Liabilities	194	382	669	-	-	**1,245**
Total Intragovernmental Liabilities	2,607	4,430	1,311	1,150,827	-	**1,159,175**
Administrative Accounts Payable	7,364	11,064	95,694	-	-	**114,122**
Accounts Payable	7,364	11,064	95,694	-	-	**114,122**
Contingent Liabilities	193,600	356,400	-	-	-	**550,000**
State Liabilities	374,919	-	-	-	-	**374,919**
Deferred Revenue and Deposit Liabilities	20	270	-	24,618	-	**24,908**
Accrued Unfunded Annual Leave and Benefits	3,901	7,181	-	-	-	**11,082**
Actuarial Liabilities	3,365	6,195	-	-	-	**9,560**
Accrued Payroll and Benefits	3,016	4,183	251	-	-	**7,450**
Capital Leases	7	14	-	-	-	**21**
Total Liabilities	588,799	389,737	97,256	1,175,445	-	**2,251,237**
Net Position						
Unexpended Appropriations	2,758	3,558	-	-	-	**6,316**
Cumulative Results of Operations:						
Administrative Cumulative Results of Operations	(152,210)	(330,413)	-	-	-	**(482,623)**
EIRF Cumulative Results of Operations	-	-	-	-	967,274	**967,274**
Total Cumulative Results of Operations	(152,210)	(330,413)	-	-	967,274	**484,651**
Total Net Position	(149,452)	(326,855)	-	-	967,274	**490,967**
Total Liabilities and Net Position	$439,347	$62,882	$97,256	$1,175,445	$967,274	**$2,742,204**

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Independent Auditors' Report

E-IN-MMS-0102-2002

United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

March 7, 2003

Memorandum

To: Director, Minerals Management Service

From: Roger La Rouche Roger LaRouche
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Minerals Management Service's Financial Statements for Fiscal Years 2002 and 2001 (No. 2003-I-0030)

We contracted with KPMG LLP (KPMG), an independent certified public accounting firm, to audit the Minerals Management Service's (MMS) financial statements as of September 30, 2002 and for the year then ended. The contract required that KPMG conduct its audit in accordance with the Comptroller General of the United States of America's *Government Auditing Standards*, the Office of Management and Budget's Bulletin 01-02 *Audit Requirements for Federal Financial Statements*, and the General Accounting Office/President's Council on Integrity and Efficiency's *Financial Audit Manual*.

In its audit report dated December 2, 2003 (Attachment 1), KPMG issued an unqualified opinion on MMS's financial statements. KPMG identified three reportable conditions, none of which were considered to be material weaknesses, related to internal controls and financial operations: (A) improve controls over information technology data security, (B) improve controls over investment reconciliation's, and (C) improve controls over the reporting of the Strategic Petroleum Reserve. With regard to compliance with laws and regulations, KPMG found MMS to be noncompliant with portions of the Federal Financial Management Improvement Act (FFMIA). Specifically, KPMG reported that MMS's financial management systems did not substantially comply with the federal financial management systems requirements or the United States Standard General Ledger at the transaction level.

In connection with the contract, we monitored the progress of the audit at key points, reviewed KPMG's report and selected related working papers, and inquired of its representatives. Our review, as differentiated from an audit in accordance with the *Government Audit Standards*, was not intended to enable us to express, and we do not express, an opinion on the MMS's financial statements, conclusions about the effectiveness of internal controls, conclusions on whether MMS's financial management systems substantially complied with the three requirements of FFMIA, or conclusions on compliance with laws and regulations. KPMG is responsible for the auditors' report and for the conclusions expressed in the report. Our review has disclosed no instances where KPMG did not comply in all material respects with the *Government Auditing Standards*.

In the January 6, 2003, response from the Director, MMS (Attachment 2), MMS concurred with all the recommendations. Based on the response recommendations A, B and C are considered resolved and implemented, and recommendations D and E are considered resolved but not implemented. Recommendations D and E will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

Section 5(a) of the *Inspector General Act* (5 U.S.C. App. 3) requires the Office of Inspector General to list this report in its semiannual report to the Congress.

Attachments (2)

2001 M Street, NW
Washington, DC 20036

ATTACHMENT 1

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of the Minerals Management Service (MMS) as of September 30, 2002 and 2001, and the related statements of custodial activity for the years then ended, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002. The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered MMS's internal control over financial reporting and tested MMS's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

Summary

As stated in our opinion on the financial statements, we concluded that the MMS's consolidated balance sheets, and the related statements of custodial activity as of and for the years ended September 30, 2002 and 2001, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. We did not audit the accompanying consolidated statement of net cost for the year ended September 30, 2001, and, accordingly, we do not express an opinion on it.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

A. Improve Information Technology (IT) data security control weaknesses

B. Improve controls over investment reconciliations

C. Improve controls over the reporting of the Strategic Petroleum Reserve (SPR)

We do not consider the reportable conditions, above, to be material weaknesses.

The results of our tests of compliance with the laws and regulations, exclusive of 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 MMS's financial management systems did not substantially comply with the federal financial management system requirements and the U.S. Standard General Ledger at the transaction level.

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the MMS as of September 30, 2002 and 2001, and the related statements of custodial activity for the years then ended, and the consolidated statement of net costs, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002. The accompanying consolidated statement of net cost for the year ended September 30, 2001 was not audited by us and, accordingly, we do not express an opinion on it.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the MMS as of September 30, 2002 and 2001, and its custodial activities for the years then ended, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, for the year ended September 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

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

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating balance sheet as of September 30, 2002 is presented for purposes of additional analysis of the consolidated balance sheet as of September 30, 2002 rather than to present the financial position of the MMS's components individually. The consolidating balance sheet as of September 30, 2002 has been subjected to the auditing procedures applied in the audit of the consolidated balance sheet as of September 30, 2002 and, in our opinion, is fairly stated in all material respects in relation to the consolidated balance sheet as of September 30, 2002 taken as a whole.

Internal Control Over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect MMS's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

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

In our fiscal year 2002 audit, we noted the following matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. However, we do not consider these reportable conditions to be material weaknesses.

A. Improve Information Technology Data Security Control Weaknesses

While we have noted that MMS has made certain improvements during fiscal year 2002 in meeting the security policies and procedure requirements of OMB Circular A-130, *Security of Federal Automated Information Resources*, we continue to note that MMS did not have adequate information security policies and procedures to meet the requirements of OMB Circular A-130. OMB Circular A-130 provides requirements to ensure adequate security for information relating to general support systems and major application systems. MMS also did not have effective policies and procedures to control and protect information systems. Specifically, we noted weaknesses in the following areas:

1. **Entity-wide Security Program:** MMS's security plan did not contain all of the information required by OMB Circular A-130, Appendix III. Specifically, MMS did not perform an adequate risk assessment of the Advanced Budget/Accounting Control and Information System (ABACIS).

2. **System Software Controls:** MMS did not establish controls to monitor operating system activities and operating system security parameters have not been set for effective logging of user activity. In addition the security monitoring and reporting process in relation to the Minerals Revenue Management Financial System (MRMFS) does not include all information systems platforms and components.

3. **Service Continuity:** MMS had not conducted recent tests of its contingency plans to minimize the risk of unplanned interruptions and to minimize the risk of recovery of critical operations to protect data should interruptions occur. In relation to the MRMFS management has not performed a walk-through test of contingency plan scenarios, nor was there documentation of the contingency plan on site. Moreover, MRM has not participated in, or reviewed the results of, the test of the contingency plan performed by UsiNet.

4. **Program Development Testing:** MMS did not properly address failed general ledger test scripts during the migration process. While a complete list of test script failures was compiled at the time of conversion, there is currently no project management process in place to ensure that failures are being addressed in an accurate and timely manner.

Recommendation

MMS should improve controls over information technology systems to ensure adequate security and protection of information resources. MMS should test contingency plans annually and analyze the results once testing has been conducted. MMS should also document and implement a project plan to ensure that each of the failed test scripts is effectively addressed and resolved.

Management's Response

<u>Entity-wide Security Program:</u> This recommendation has been implemented. An independent risk assessment of the ABACIS was completed by RGII on August 20, 2002. The cover was provided to

KPMG as evidence that an assessment had been conducted. MMS acknowledges that the assessment was not completed by the original target date of June 30, 2002.

System Software Controls: This recommendation as it pertains to the ABACIS has been implemented. All access to the Hewlett Packard (HP), operating platform for the ABACIS, are logged on the console. Reports are available and MMS staff have begun monitoring these reports bi-weekly. Systems manager capabilities are limited to only two MMS employees (located in the A&B Information Resources Technology Division). Application development is limited to staff in Financial Management. MMS believes that this level of monitoring is sufficient to ensure the HP operating system is not degraded by unauthorized use.

With respect to the MRM Financial System, MMS recognizes the need to update its policies and procedures to reflect the new Minerals Revenue Management reengineered architecture. The ITC (Information Technology Center) recently formed an Architecture Group which includes responsibility for such documentation. The MRM Management is in the process of documenting and implementing policies and procedures including those for access requests, system software utilities, and SDLC methodologies. Target completion date is September 2003. However, an influencing factor in these ongoing revisions will be new guidance from the department and bureau level in all of these areas over the next six months.

Service Continuity: Full compliance with this recommendation is in process. MMS has documented applicable contingency plans. As with all other DOI bureaus, MMS disabled its networks in response to the U.S. District Court order, dated December 6, 2001. The Special Master's IT contractor (IBM) conducted extensive analysis and determined the MMS Gulf of Mexico Region provided the safest and most secure site to support reconnection of the bureau's Internet connections. MMS essentially tested its contingency plans by realigning the entire bureau's connections through the Gulf site. KPMG acknowledged this in the Notice of Findings and Recommendations issued for this item.

Testing of the ABACIS contingency plans was not conducted because of firewall issues with the Office of Surface Mining and Reclamation (manager of the contingency site). Testing was completed November 30, 2002.

USi has developed a contingency plan, but MRM management does not have immediate access to the plan. What MMS does have is the USi contingency architecture and contingency test plan for testing November 8-11. MMS has received the results of this test. Lessons learned in the test focused on corrections to be made in future tests.

Accenture and USi are contractually required to provide the contingency service so the test was a key process. In the absence of a demonstration that this service is not being provided, MMS does not see a need to have access to the USi contingency plan which covers internal processes and procedures for failover.

Program Development Testing: This recommendation has been implemented. All failed initial test script results and workarounds and stringent internal controls were discussed with KPMG during the audit. MMS will document the impacts and risk assessment when a decision is made to not test or implement a particular software feature. Note, however, that MMS has a formal documented process used to request program modifications to the MRM Financial System (System Investigation Request [SIR]). The request process must be documented, approved by the requesting supervisor and submitted to the contracting officer's technical representative for final approval. All SIRs are prioritized by MRM management and worked by the contractor as resources are available. The SIRs are tracked and monitored by MRM and the contractor to ensure completion of critical system modifications. Completion entails contractor system test, MRM review of system testing, MRM testing of the change(s), and MRM approval prior to production implementation. Additionally, MRM has acquired contractor resources to resolve general ledger problems for which a workaround was not identified.

B. Improve Controls Over Investment Reconciliations

We noted that quarterly reconciliations of investments held in the Environmental Improvement and Restoration Fund (EIRF) are not effectively performed to ensure that balances recorded in the general ledger agree to those reported by Treasury. In addition, certifications of investments balances to Treasury are not timely.

Recommendation

We recommend that management improve the reconciliation process to require periodic reconciliation of the amounts reported by Treasury to the general ledger. We also recommend that management implement policies that ensure Treasury certifications are performed within a reasonable time from the availability of information from Treasury.

Management's Response

This recommendation has been implemented. MMS procedures have been modified to require reconciliation of investment activity between the Treasury balances and the MRMFS general ledger. The General Ledger team supervisor reviews and confirms the reconciliation and certification process. The delays in performing the Treasury certifications were due to the internet shutdown and workloads associated with the resultant backlogs.

C. Improve controls over the reporting of the Strategic Petroleum Reserve

We noted that calculations of Strategic Petroleum Reserve (SPR) amounts are not sufficiently reviewed to ensure an accurate calculation and recording of SPR amounts. During our test-work over the amount of recorded SPR collections, we noted that for the September calculation, incorrect Platts prices were used when valuing the SPR. Instead of using the September Platts prices, October prices were inadvertently used. The impact of using the incorrect Platts price was an overstatement of SPR Revenue and related Disposition of Revenue on the Statement of Custodial Activity by approximately $2.8 million.

Recommendation

We recommend that management improve the management review of the SPR calculation process to ensure accurate recording of the SPR.

Management's Response

This recommendation has been implemented. MMS agrees with the spirit of the finding and recommendation, and has instituted an added quality assurance/quality control procedure to provide an independent review of all data and calculations used to arrive at the valuation of the wellhead crude oil volumes involved in the Strategic Petroleum Reserve (SPR) fill initiative. Additionally, MMS is tasking the Royalty-In-Kind (RIK) systems integrator contractor, Accenture LLP, with supporting the valuation of SPR wellhead crude oil volumes through the upcoming RIK oil management system implementation.

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

Compliance with Laws and Regulations

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

The results of our tests of FFMIA disclosed instances, described below, where MMS's financial management systems did not substantially comply with the federal financial management systems requirements and the U.S. Standard General Ledger at the transaction level.

D. Federal Financial Management System Requirements

As previously discussed in the Internal Control Over Financial Reporting section of this report, MMS did not have adequate information security policies and procedures to meet the federal financial management system requirements of FFMIA.

Recommendation

We recommend that management improve controls over information technology systems to ensure adequate security and protection of information resources and to meet the requirements of FFMIA.

Management's Response

MMS acknowledges deficiencies with respect to written security policies and procedures and has awarded a contract to *SAIC* to review and ensure MMS's full compliance with OMB Circular A-130 (also reference internal control response above). This effort will be completed by December 2003.

E. U.S. Standard General Ledger at the Transaction Level

The Minerals Revenue Management Financial System (MRMFS) is not in full compliance with FFMIA requirements in relation to the U.S. Standard General Ledger at the transaction level. During our test-work, we noted the following:

- Approximately 30 non-standard journal entries were required to be posted in order to produce a complete trial balance.
- Accounting posting models, SGL accounts, and attributes are not consistent with Treasury standard models and the Department of the Interior (DOI) chart of accounts. For example, custodial revenue accounts 5740 and 5745 in the MRMFS system are not consistent with DOI guidance and must be converted to 5900 and 5990, respectively for reporting purposes. We also noted that posting requirements for general receipt accounts are not being used. These deficiencies, as well as other posting issues, required conversion of the data by SGL account for upload into the DOI reporting system.
- Insufficient pre-established posting models exist to meet MRM's mission needs. We noted, for example, that there are not pre-established posting models to record investment activity, transfers of cash between federal and Indian business units, bonus money received on lease sales, and refunds.
- System inability to properly post trading partner information that complicated and delayed the eliminations process between MMS and its trading partners.

Recommendation

We recommend that management develop and implement a corrective action plan to ensure that the MRMFS is developed to the extent necessary to meet the U.S. Standard General Ledger at the transaction level requirements of FFMIA.

Management's Response

MMS acknowledges that additional work is needed for full-compliance with this section of the FFMIA. System Investigation Requests (SIRs) have or will be documented to modify the accounting models to meet the U.S. Standard General Ledger transactional level requirements of FFMIA. Target completion date is June 30, 2003.

The results of our tests of FFMIA disclosed no instances in which the MMS financial management systems did not substantially comply with the federal accounting standards.

Responsibilities

Management's Responsibilities

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

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures);
- 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 consolidated balance sheets of the MMS as of September 30, 2002 and 2001, and the related statements of custodial activity for the years then ended, and the related consolidated statement of net cost, consolidated statement of changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year ended September 30, 2002 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 referred to above 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 audits, we considered MMS's internal control over financial reporting by obtaining an understanding of the MMS's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

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

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

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

Distribution

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

December 2, 2002

Exhibit I

Minerals Management Service
Summary of the Status of Prior Year Findings
September 30, 2002

Ref	Condition Area	Status
01-A	MMS did not have adequate information security policies and procedures to meet requirements of OMB Circular A130, Security of Federal Automated Information Resources.	While MMS has made some progress in addressing this issue, it has not fully corrected the condition related to Entity-wide Security Program, Access Controls, System Software Controls, Service Continuity.
01-B	Improve Controls Over Year-end Accounts Payable and Accounts Receivable Accrual Process	Substantial progress has been made by MMS in addressing this issue and it is no longer considered a reportable condition.
01-C	Compliance with Laws and Regulations: Prompt Payment Act	Substantial progress has been made by MMS in addressing this issue and it is no longer considered a reportable condition.
01-D	Compliance with Laws and Regulations: FFMIA	Substantial progress has been made in addressing this issue and it is no longer considered a reportable condition in relation to the prior year finding. We did, however, identify non-compliance with system requirements and the U.S. SGL at the transaction level for the MRMFS system implemented in the current fiscal year. The finding in our current report is not related to the prior year non-compliance.

ATTACHMENT 2

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

JAN -8 2003

Memorandum

To: Assistant Inspector General for Audits

Through: Rebecca W. Watson Rebecca W. Watson JAN - 9 2003
Assistant Secretary – Land and Minerals Management

From: R. M. "Johnnie" Burton
Director

Subject: Draft Independent Auditors' Report on the Minerals Management Service's Financial Statements for Fiscal Years 2002 and 2001
(Assignment Number: E-IN-MMS-0102-2002)

Thank you for the opportunity to respond to the draft independent auditors' report on MMS's financial statements for fiscal years 2002 and 2001. We concur with the independent auditors' (KPMG) findings of three reportable conditions related to internal controls over financial operations. These reportable conditions are not considered to be material weaknesses. We also agree with the auditors' findings and two recommendations related to compliance with laws and regulations.

In our Attachment, we are providing our comments on the findings and five recommendations showing how we have implemented two of the recommendations and are in the process of implementing the other three.

Please contact Bettine Montgomery at (202) 208-3976 if you have any further questions.

Attachment

Minerals Management Service Response to the Draft Independent Auditors' Report On Financial Statements for Fiscal Years 2002 and 2001

Audit Agency: KPMG **Assignment Number:** E-IN-OMMS-0102-2002

General Comment

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

INTERNAL CONTROL OVER FINANCIAL REPORTING

A. Improve Information Technology Data Security Control Weakness

- **Entity-wide Security Program**: MMS's security plan did not contain all of the information required by OMB Circular A-130, Appendix III. Specifically, MMS did not perform an adequate risk assessment of the Advanced Budget/Accounting Control and Information System (ABACIS).

- **System Software Controls**: MMS did not establish controls to monitor operating system activities and operating system security parameters have not been set for effective logging of user activity. In addition, the security monitoring and reporting process in relation to the Minerals Revenue Management (MRM) Financial System does not include all information systems platforms and components.

- **Service Continuity**: MMS had not conducted recent tests of its contingency plans to minimize the risk of unplanned interruptions and to minimize the risk of recovery of critical operations to protect data should interruptions occur. In relation to the MRM Financial System, management has not performed a walk-through test of contingency plan scenarios, nor was there documentation of the contingency plan on site. Moreover, MRM has not participated in, or reviewed the results of, the rest of the contingency plan performed by UsiNet.

- **Program Development Testing**: MMS's MRM did not properly address failed general ledger test scripts during the migration process. While a complete list of test script failures was compiled at the time of conversion, there is currently no project management process in place to ensure that failures are being addressed in an accurate and timely manner.

Recommendation

MMS should improve controls over information technology systems to ensure adequate security and protection of information resources. MMS should test contingency plans annually and analyze the results once testing has been conducted. MMS should also document and implement a project plan to ensure that each of the failed test scripts is effectively addressed and resolved.

MMS Response

Entity-wide Security Program: This recommendation has been implemented. An independent risk assessment of the ABACIS was completed by RGII on August 20, 2002. The cover was provided to KPMG as evidence that an assessment had been conducted. MMS acknowledges that the assessment was not completed by the original target date of June 30, 2002.

System Software Controls: This recommendation as it pertains to the ABACIS has been implemented. All access to the Hewlett Packard (HP), operating platform for the ABACIS, are logged on the console. Reports are available, and MMS staff have begun monitoring these reports bi-weekly. Systems manager capabilities are limited to only two MMS employees (located in the A&B Information Resources Technology Division). Application development is limited to staff in Financial Management. MMS believes that this level of monitoring is sufficient to ensure the HP operating system is not degraded by unauthorized use.

With respect to the MRM Financial System, MMS recognizes the need to update its policies and procedures to reflect the new MRM reengineered architecture. The ITC (Information Technology Center) recently formed an Architecture Group which has responsibility for such documentation. The MRM management is in the process of documenting and implementing policies and procedures including those for access requests, system software utilities, and SDLC methodologies. **Target completion date is September 2003**. However, an influencing factor in these ongoing revisions will be new guidance from the DOI and Bureau level in all of these areas over the next 6 months.

Service Continuity: Full compliance with this recommendation is in process. MMS has documented applicable contingency plans. As with all other DOI Bureaus, MMS disabled its networks in response to the U.S. District Court order dated December 6, 2001. The Special Master's IT contractor (IBM) conducted extensive analysis and determined the MMS Gulf of Mexico Region provided the safest and most secure site to support reconnection of the Bureau's internet connections. MMS essentially tested its contingency plans by realigning the entire Bureau's connections through the Gulf site. KPMG acknowledged this in the Notice of Findings and Recommendations issued for this item.

Testing of the ABACIS contingency plans was postponed because of firewall issues with the Office of Surface Mining and Reclamation (manager of the contingency site). Testing was completed November 30, 2002.

The USinternetworking (USi) contingency plan is now available on site with MRM's contractor, Accenture. A test of the plan was completed in November 2002, and the results have been reviewed by MRM. Lessons learned in the test focused on corrections to be made in future tests. During 2003, MMS plans to conduct a walk-through test of contingency plan scenarios for MRM accounting operations (in addition to the system contingencies covered under the USi test).

Program Development Testing: This recommendation has been implemented. All failed initial test script results and workarounds and stringent internal controls were discussed with KPMG during the audit. MMS will document the impacts and risk assessment when a decision is made to not test or implement a particular software feature. Note, however, that MMS has a formal documented process used to request program modifications to the MRM Financial System (System Investigation Request (SIR)). The request process must be documented, approved by the requesting Supervisor, and submitted to the Contracting Officer's Technical Representative for final approval. All SIRs are prioritized by MRM management and worked by the contractor as resources are available. The SIRs are tracked and monitored by MRM and the contractor to ensure completion of critical system modifications. Completion entails contractor system test, MRM review of system testing, MRM testing of the change(s), and MRM approval prior to production implementation. Additionally, MRM has acquired contractor resources to resolve general ledger problems for which a workaround was not identified.

Recommendation: In Process. We are in the process of implementing this Recommendation as detailed in our responses to the four Findings above. **Target completion date is September 30, 2003.**

B. Improve controls over investment reconciliations

We noted that quarterly reconciliations of investments held in the Environmental Improvement and Restoration Fund (EIRF) are not effectively performed to ensure that balances recorded in the general ledger agree to those reported by Treasury. In addition, certifications of investments balances to Treasury are not timely.

Recommendation

We recommend that management improve the reconciliation process to require periodic reconciliation of the amounts reported by Treasury to the general ledger. We also recommend that management implement policies that ensure Treasury certifications are performed within a reasonable time from the availability of information from Treasury.

MMS Response

This recommendation has been implemented. Our procedures have been modified to require reconciliation of investment activity between the Treasury balances and the MRM Financial System general ledger. The General Ledger Team supervisor reviews and confirms the reconciliation and certification process. The delays in performing the

Treasury certifications were due to the internet shutdown and workloads associated with the resultant backlogs.

C. Improve controls over the reporting of the Strategic Petroleum Reserve

We noted that calculations of Strategic Petroleum Reserve (SPR) amounts are not sufficiently reviewed to ensure an accurate calculation and recording of SPR amounts. During our test work over the amount of recorded SPR collections, we noted that for the September calculation, incorrect Platts prices were used when valuing the SPR. Instead of using the September Platts prices, October prices were inadvertently used. The impact of using the incorrect Platts price was an overstatement of SPR Revenue and related Disposition of Revenue on the Statement of Custodial Activity by approximately $2.8 million.

Recommendation

We recommend that management improve the management review of the SPR calculation process to ensure recording of the SPR.

MMS Response

This recommendation has been implemented. We agree to the spirit of the finding and recommendation, and we have instituted an added quality assurance/quality control procedure to provide an independent review of all data and calculations used to arrive at the valuation of the wellhead crude oil volumes involved in the SPR fill initiative. Additionally, we are tasking our Royalty-In-Kind (RIK) systems integrator contractor, Accenture LLP, with supporting the valuation of SPR wellhead crude oil volumes through the upcoming RIK oil management system implementation.

We note that the valuation of the wellhead volumes involved in the SPR fill initiative is included in the annual financial statement to provide as close an estimate as possible of the monetary value of an exchange transaction between DOI and DOE that does not involve any monetary exchange or collections of any kind. Thus, above, under C. Improve controls over the reporting of the Strategic Petroleum Reserve, reference to "SPR collections" is not accurate.

We further note that, as footnoted in our calculations on the annual financial statement, the September 2002 calculations of the SPR crude oil valuation were estimates due to the fact that actual volume data was not available at the time of reporting. Using the final actual volume data now available, the FY 2002 SPR valuation of wellhead crude oil involved in the SPR fill initiative is approximately $38,040,455 or $7,199,884 less than the correct estimated calculation that should have appeared on the annual financial statement. For each fiscal year of the SPR fill initiative, valuation of the last months' production will require estimates that will, by definition, not be equal to actual values.

COMPLIANCE WITH LAWS AND REGULATIONS

D. Federal Financial Management System Requirements

As previously discussed in the Internal Control Over Financial Reporting section of this report, MMS did not have adequate information security policies and procedures to meet the Federal financial management system requirements of FFMIA.

Recommendation

We recommend that management improve controls over information technology systems to ensure adequate security and protection of information resources and to meet the requirements of FFMIA.

MMS Response

In Process. MMS acknowledges deficiencies with respect to written security policies and procedures and has awarded a contract to *SAIC* to review and ensure MMS' full compliance with OMB Circular A-130 (also reference internal control response above). **This effort will be completed by December 31, 2003.**

E. U.S. Standard General Ledger at the Transaction Level

The MRM Financial System is not in full compliance with FFMIA, Public Law 104-209, Title VIII (31 U.S.C. 3512 note). During out test work, we noted the following:

- Numerous non-standard journal vouchers were posted in order to produce a complete trial balance. We noted that MMS made approximately 28 non-standard journal entries in-order to produce trial balance.

- Accounting posting models, SGL accounts, and attributes are not consistent with Treasury's standard models and DOI's accounts. For example, custodial revenue accounts 5740 and 5745 in the MRM Financial System are not consistent with DOI guidance and must be converted to 5900 and 5990, respectively for reporting purposes. We also noted that posting requirements for general receipt accounts are not being used. These deficiencies, as well as other posting issues, required conversion of the data by SGL account for upload into the DOI reporting system.

- An insufficiency of pre-established posting models to meet MRM's mission needs. We noted, for example, that there are not pre-established posting models to record investment activity, transfers of cash between Federal and Indian business units, bonus money received on lease sales, and refunds.

- System inability to properly post trading partner information that complicated and delayed the eliminations process between MMS and its trading partners.

Recommendation

We recommend that management develop and implement a corrective action plan to ensure that the MRM Financial System is developed to the extent necessary to meet the U.S. Standard General Ledger at the transaction level requirements of FFMIA.

MMS Response

In Process. MMS acknowledges the additional work needed for full-compliance with this section of the FFMIA. SIRs have or will be documented to modify the accounting models to meet the U.S. Standard General Ledger transactional level requirements of FFMIA. **Target completion date is June 30, 2003.**

Conclusion

In conclusion, we acknowledge the KPMG findings, and we either have or are taking necessary steps to implement the recommendations. We expect continued success receiving unqualified independent audit opinions on future financial statements.

The Responsible Official is the Chief Financial Officer for MMS.

The Department of the Interior Mission

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

The Minerals Management Service Mission

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

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

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