Fiscal Year 1997 Annual Financial Report

15 Years of Excellence
1982-1997

Minerals Management Service

February 1998

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Message from the Director

The year 1997 marked the 15th anniversary of the Minerals Management Service (MMS). Over the years, the MMS has changed dramatically in response to changing political, economic, and business climates, and a variety of other internal and external forces. Now, as we approach the 21st Century, we are faced with a new array of conditions to which we must respond. Furthermore, declining budgets require us to become more streamlined and efficient while maintaining the highest standards for safety, environmental and financial accountability, and customer service.

Fiscal Year 1997 was a very productive year for the MMS. We distributed about $6 billion in mineral revenues from leases on Indian lands, and from Federal onshore and offshore leases. We directly administered approximately 25 million acres of Federal offshore lands (active leases). Based on the latest available data, these lands supply about 27 percent of the United States' total natural gas production and more than 18 percent of its total oil production. We also conducted three lease sales during the year, with high bids totaling over $1.2 billion, a 35 percent increase over FY 1996. This dramatic increase is a direct result of industry's renewed interest in drilling in the Gulf of Mexico. It is anticipated that over the next few years production of oil from the Gulf of Mexico will double to approximately 2 million barrels a day. Operations of the MMS contribute significantly to the Nation's energy needs and provide billions of dollars to the U.S. Treasury each year.

The activities noted on the following pages provide just a few examples of how we are meeting the varied and sometimes conflicting challenges that confront us. Taken together, I believe they reflect our deep commitment to the vision of the MMS – to be recognized as the best minerals resource manager.

If you want to know more about the MMS and our many activities, please visit our home page at **www.mms.gov.**

Cynthia Quarterman
Director

Minerals Management Service

Annual Financial Report of Fiscal Year 1997 Activity

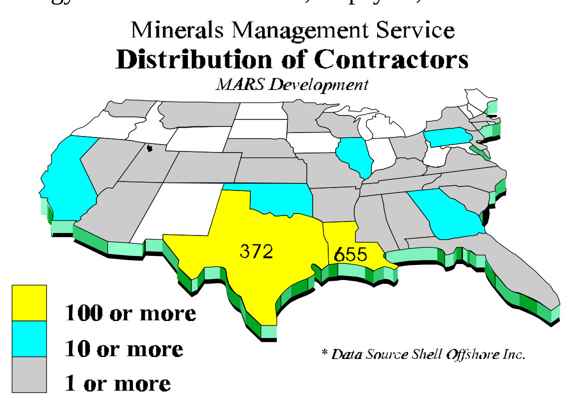
Minerals Management Service (MMS) manages the Nation's natural gas, oil, and other mineral resources on the Outer Continental Shelf (OCS), and collects, accounts for, and disburses revenues from offshore Federal mineral leases and from onshore mineral leases on Federal and Indian lands.

Mission Statement

To manage the mineral resources on the Outer Continental Shelf in an environmentally sound and safe manner and to timely collect, verify, and distribute mineral revenues from Federal and Indian lands.

The 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.

Although a relatively small bureau (approximately 1,700 employees located in 20 cities across the United States), activities of the MMS provide major economic and energy benefits to the Nation, taxpayers, States and the Indian community -- benefits that have both national and local significance. For example, the map above shows the distribution of contractors that have supplied materials or services in support of a single deep water development (MARS) in the Gulf of Mexico (GOM). While the great majority of contractors are located in the

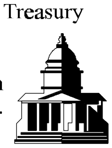


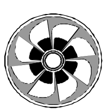
MM$

Where Did the Money Go in FY 1997?

MMS operations contributed approximately $3.8 billion to the general fund of the U.S. Treasury

MMS collected and disbursed an estimated $685 million to 36 States.



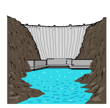


MMS accounts for approximately $191 million of Indian tribes and allottee transfers. About $54 million was collected and disbursed by MMS.

The $896 million from OCS receipts accounted for virtually all of the funding for the Land and Water Conservation Fund.

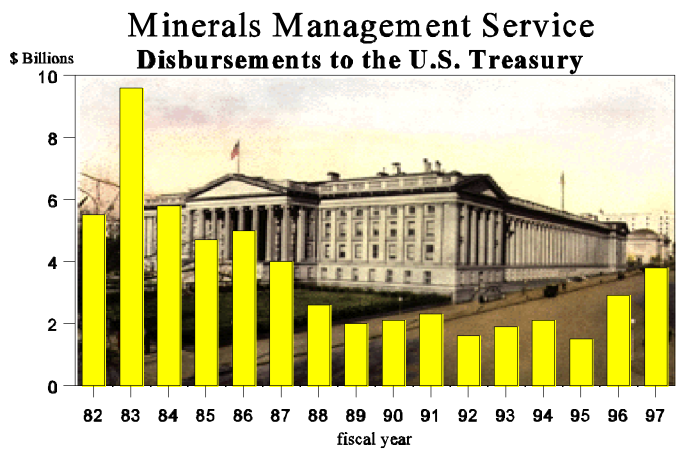
The $150 million in OCS receipts was the sole source of funding for the National Historic Preservation Fund.

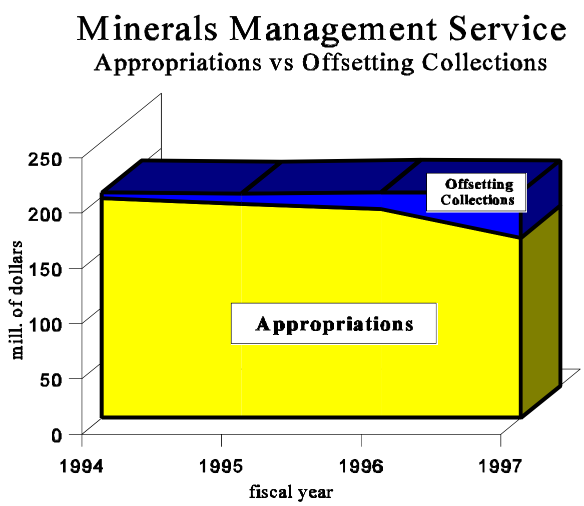
Approximately $443 million in MMS receipts went to the Reclamation Fund of the Bureau of Reclamation.



States of Texas and Louisiana, contractors from all over the country are involved in and benefit from OCS development.

Since 1982, roughly $90 billion in revenues from mineral activities on Federal lands has been distributed by the MMS to the U.S. Treasury, States, tribes and Indian allottees *(see chart on page 1 for annual disbursements for fiscal year 1997)*. A portion of the revenues distributed to the U.S. Treasury goes into accounts that support the Land and Water Conservation Fund and the National Historic Preservation Fund. The largest recipient of funds produced by the MMS is the General Fund of the U.S. Treasury. Since 1982 the Treasury has received over $57 billion in MMS collections. The FY 1997 disbursement to the General Fund is the largest in over 10 years and represents a resurgence in OCS activity in the GOM.





The OCS continues to play a significant role in our Nation's energy picture. The MMS administers 27 million acres of the OCS under active lease, which supplies over 27 percent of the natural gas and more than 18 percent of the oil produced in the United States (June 1996 - June 1997). To date, the OCS has produced about 120 trillion cubic feet of natural gas and about 11 billion barrels of oil. Annual oil production increased in both the GOM and the Pacific in 1997. It is projected that while oil production in the Pacific will level off or even decline slightly, production in the GOM will continue to increase dramatically resulting in hundreds of millions of dollars annually for the U.S. Treasury.

While development of offshore mineral resources has already meant billions of dollars in revenues to the United States, the MMS is extremely concerned with safety and environmental concerns -- striving to provide domestic energy while protecting sensitive coastal and marine environments.

Organization

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

Offices of the MMS 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, the MMS has RMP compliance (audit) and OMM District Offices located near major centers of the oil and gas industry.

The operations of the MMS are primarily funded from two appropriations: Royalty and Offshore Minerals Management (ROMM) and Oil Spill Research (OSR); and offsetting collections from OCS activities. Each year since FY 1994, when offsetting collections were first authorized, MMS funding from appropriations has declined. By FY 1997, appropriations accounted for only about 80 percent of the total MMS funding. Total MMS funding has increased slightly during this time *(see chart on previous page)*.

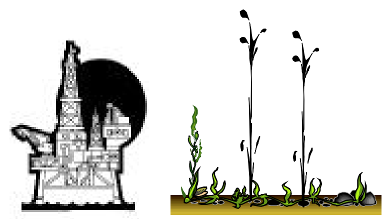
Offshore Minerals Management

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

The OCS Lands 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 resources; and
- ☞ Balance the various environmental and resource issues and concerns of affected parties.

Did You Know?



Since 1980 natural seeps have leaked over 1,000,000 barrels of oil into the marine environment off southern California. During this same time, less then 1,000 barrels of oil have been spilled from offshore oil platforms in the southern California area.

Royalty Management

The Royalty Management Program (RMP) is that part of the MMS which 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 RMP collects mineral leasing revenues from Indian lands and transfers these monies to the Office of Trust Funds Management for distribution to either the appropriate tribe or individual Indian mineral owners.

The RMP is not a land administration organization. Therefore, unlike the MMS Offshore Program, the Bureau of Indian Affairs (BIA), or the Bureau of Land Management (BLM), it does not determine the lease contract conditions (*amount of rent, bonuses, or royalty rate to charge, or any lease compliance requirements)*. Rather,the role of the RMP is to determine the market value *(gross proceeds)* on which the royalty rate is applied to determine the recipient's share of revenues. This is both complicated and often contentious with revenue sharers (States, counties, Indian mineral owners, and industry). As part of this role, RMP auditors conduct on-site studies of payors' accounting records to determine if the proper amount has been paid and to review refund requests. During the last ten years, over $1 billion has been collected through these studies. This amounts to almost twice the total budget of the entire RMP over the same time period.

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

Activities of Note

MMS Accepts Award for Innovative Achievement Program

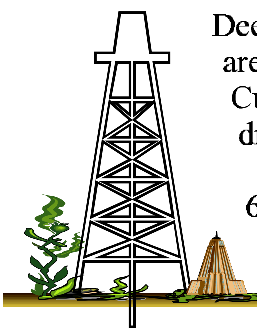
The MMS was awarded Vice President Albert Gore's National Performance Review "Hammer Award" for the Bureau's Innovative Achievements Program, a Bureau-wide, staff-driven improvements initiative. The Hammer Award is based upon the principles of putting customers first, cutting red tape, empowering employees, and getting back to basics. The award—a $6 hammer wrapped in red, white, and blue ribbon—symbolizes the reinvention and dramatic change from the days when the Federal Government paid $400 for a hammer to become a more efficient and better run government.

Over the past two years, the MMS has evolved from a traditional agency to a customer and mission driven organization. To guide this process, MMS Director Cynthia Quarterman established the Innovative Achievements Program which challenged all MMS employees to actively participate in transforming the Bureau. The Innovative Achievements Program began as a grass-roots effort and has become a widely accepted, Bureau-wide initiative to encourage employee creativity, to streamline work processes, and to improve customer service.

On presenting the award in New Orleans, Deputy Secretary of the Interior John Garamendi said, "MMS has renewed its commitment to common sense government by delivering outstanding customer service, developing creative partnerships, and involving employees in identifying opportunities for improvement and problem solving. This program has allowed MMS to reinvent and improve the programs and operational methods across the entire organization."

The first innovative achievement of the MMS was announced in September 1995, and employees have since developed and implemented 22 additional ideas such as: establishing an internship program for Indian tribes with mineral resources, issuing new well naming and numbering standards, revising testing requirements for blow-out preventers, simplifying environmental impact statements, reducing paperwork for industry, offering free electronic reporting software, and implementing a new audit tracking system.

Did You Know?



Deepwater drilling records are being set in the GOM. Currently wells are being drilled in over 7,500 feet of water. This is about 6 times the height of the Empire State Building.

Not drawn to scale

Royalty Simplification and Fairness Act

On August 13, 1996, the President signed into law the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (RSFA). The MMS is developing and executing a detailed plan for implementing the RSFA changes within the time frames required by the statute. This legislation :

- ☞ Provides the framework for additional delegations of royalty functions to States, subject to Secretarial discretion;
- ☞ Stipulates that enforcement actions will include notification of all potentially affected operating rights owners, a seven-year statute of limitations for all royalty collections, and a six-year limit on adjustments to provide more certainty for RMP and royalty payors;
- ☞ Establishes a 33-month limit for resolving all administrative appeals;

- Ensures financial equity for industry by requiring Federal payment of interest on industry overpayments;

- Requires that the MMS conduct cost-effective audit and collection activities;

- Provides administrative relief to encourage continued oil and gas production from marginal properties; and

- Repeals the outdated offshore refund requirements.

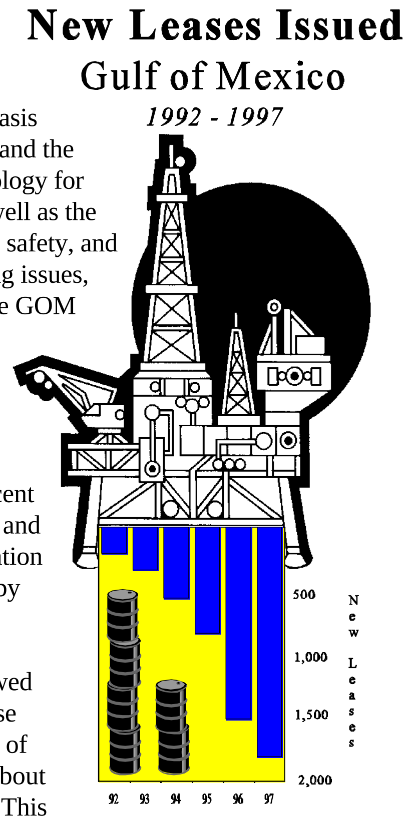
Beginning in 1997, the MMS began executing many systems and operational changes to meet the requirements of RSFA. Implementation will also require regulatory changes, involving a large-scale coordinated effort with States, industry, and other Department of the Interior Bureaus.

As we implement RSFA, we are committed to developing the best and most cost-effective operational strategies and organizational structures for the future. We will modify current automated systems and reporting processes within our FY 1998 budget request. We are in the process of defining future needs and the associated funding levels.

Renewed Leasing in the GOM

Because of technology, new discoveries, and the passage of the Deep Water Royalty Relief Act (DWRRA) of 1995, there has been a renewed interest in leasing, especially deep water leasing, in the GOM. During FY 1996, the number of new leases in the GOM increased by 80 percent. In FY 1997, the number of new leases increased by another 20 percent *(see chart)*. For the past two years each sale in the GOM has set a new record for the number of tracts leased.

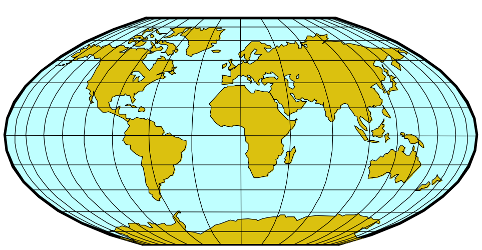
Starting in 1997, and increasing steadily in subsequent years, this new trend in leasing will result in both increased exploration and development workloads on MMS. Each development plan (and especially those in deep water) will require even more focused environmental analysis and complex technical review, platform approval, visits to construction yards for on-site inspections, and safety inspections of development operations. Increased emphasis on deep water development and the associated innovative technology for drilling and production, as well as the need to address engineering, safety, and unique supplemental bonding issues, will present challenges to the GOM Region's regulatory function.



The number of inspections conducted in the GOM is expected to increase 20 percent in FY 1998. Between 1992 and 1995, the number of exploration plan applications increased by 70 percent.

It is projected that this renewed activity in the GOM will raise current GOM oil production of 940,000 barrels per day to about 1.7 million barrels per day. This could translate into approximately $50 million per month in additional royalties.

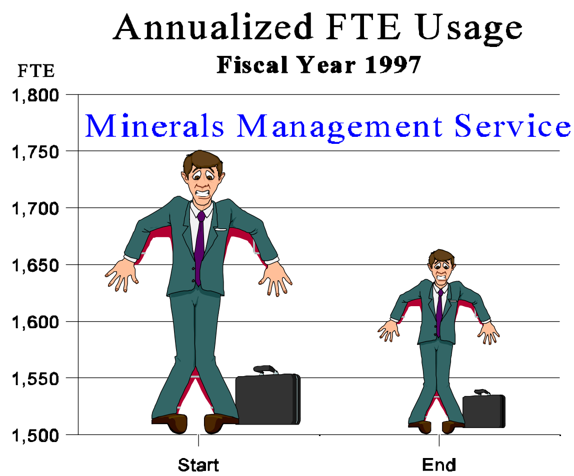
Did You Know?



If all the oil and gas pipelines in the GOM were laid in a straight line, they would circle the earth.

Deep Water Royalty Relief

The DWRRA established a royalty suspension program for both new and existing deep water leases in the GOM. A final rule modifying the bidding systems that can be used to offer OCS tracts for lease was issued in February 1996. Two final rules will be issued in 1998. These regulations will deal with specifying the terms under which the MMS makes royalty suspension available on new deep water leases and the DWRRA's provisions for granting royalty suspension to leases in the GOM issued before November 28, 1995. The result will be a more balanced and responsive application process that reduces data requirements and ensures receipt of fair market value.



The MMS, along with Louisiana State University, sponsored a Deep Water Drilling Workshop in July 1997. This workshop promoted dialog among academia, scientists, industry, and MMS representatives concerning the potential development of new technology for drilling in ultra-deep water. The focus of the workshop was on defining environmental and socioeconomic problems unique to deep water operations as well as potential solutions.

Sand and Gravel

In FY 1997, the MMS continued its partnership with ten States along the Atlantic and Gulf Coasts. These partnerships focus on identifying sand resources in Federal/State waters. This cooperative effort pools Federal and State resources in an efficient and cost-effective manner, providing environmental information to assist Federal and State agencies in making decisions on the use of offshore sand. In addition, there are four States that have or are currently negotiating agreements for sand use with the MMS.

Annual Operator Performance Review

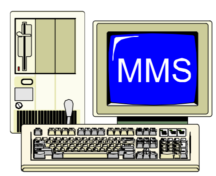
In mid FY 1997, the MMS developed and implemented a program to conduct annual operator performance reviews. The reviews act as a tool to assess how well the industry is performing relative to regulatory compliance measures. The annual reviews focus on operators' safety records and sharing of best practices.

MMS 2000

Since 1992, the MMS, like many Government agencies, has had to adjust to increased demands for services while undergoing reductions in both staff *(see chart)* and funding. In order to operate in this new environment, the MMS has been continually reevaluating how it goes about its business. In FY1995, the MMS initiated a process which evaluated every part of the organization to see if it could be streamlined or improved to better serve our constituents' needs. These processes resulted in *MMS 2000*, a comprehensive reorganization of the entire Bureau. The plan received Congressional approval in November 1996, and it was implemented in January 1997. *MMS 2000* was developed with input from all levels of the MMS. It was designed to result in a more efficient and effective organization, to make the MMS more responsive to its overall mission, and to move the MMS of today toward the MMS envisioned in its Strategic Plan. The results of the reorganization included reducing management layers and providing increased opportunities for the delegation of decision making to lower levels. *MMS 2000* was accomplished within the existing allocated FTE ceiling and budget.

MMS Online

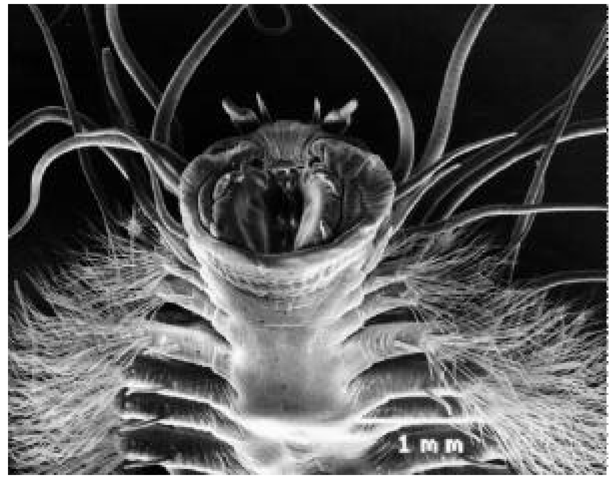
Information about the MMS can now be obtained 24 hours a day by anyone with Internet access. The MMS home page may be found at www.mms.gov. The home page contains the most current information on the MMS. Through the Internet, a user may obtain copies of the latest proposed regulations, search through the extensive MMS Environmental Studies Database, check on upcoming MMS-sponsored events, read MMS publications, or contact an MMS employee.



New Species Discovered in GOM

Scientists discovered a previously unknown animal living in the cold depths of the GOM. This new species of worm was discovered during an MMS-sponsored study of the biogeochemical processes that support chemosynthetic communities.

On a July 15, 1997 research diver, Charles Fisher, Ph.D., of Penn State University, discovered the new worm. The worms (now called ice worms) are about 1-2 inches in length and live by the hundreds on mounds of frozen methane, water, and other hydrocarbon deposits at a depth of over 1,800 feet. The worms were observed using oar-like appendages to move around the methane mounds. It is not known if the ice worms use the mounds for protection or nourishment. With this discovery the previously held view that the deep sea bottom is a monotonous and lifeless environment needs to be discarded.



Royalty in Kind

During September 1997, the MMS released the final report of its 1997 Royalty-in-Kind (RIK) Feasibility Study Team, which assesses the potential for the United States to take its oil and natural gas "royalties in kind." The study concludes that, if implemented correctly, RIK programs could be workable, revenue positive, and administratively more efficient for all parties, where appropriate. The MMS may be able to realize value enhancements from aggregating and fully marketing gas production at down-stream production centers. The report also identifies unfavorable conditions that would reduce chances for successful programs, including legislation reducing the Federal Government's statutory or contractual RIK authorities. The report recommends further examining and developing detailed RIK strategies in the following areas: (1) oil production in Wyoming; (2) natural gas production in the Gulf of Mexico; and (3) Outer Continental Shelf Lands Act, Section 8(g) production offshore Texas. The study concludes that an "in kind" program for natural gas from the Gulf of Mexico has the most potential for success because of the magnitude and concentration of supply, production, and transportation infrastructures. By contrast, the report does not endorse widespread implementation of RIK programs for crude oil, due to uncertainty in revenue implications.

Before moving forward with the implementation of RIK programs, MMS will take certain steps to confirm that such programs are administratively feasible and fiscally sound. One of the first steps is to conduct a detailed revenue impact analysis that would assess the market risks and costs MMS would face in this new arena. Based on the analysis, decisions will be made on whether to proceed with implementation of a pilot program in a given area.

Did You Know?

Royalties from offshore oil and gas activities provide funding for the National Historic Preservation Fund (NHPF). Through its many programs the NHPF has contributed to the restoration of over 26,000 historic buildings all across the Nation.

Contract Settlements

During the past 10 years, many energy purchasers, particularly pipeline companies, negotiated with mineral producers to rescind, terminate, limit, or otherwise modify sales contracts containing unrealistic purchase prices and/or volumes. In return, mineral producers frequently received monies in settlement of the contractual obligations. Since these settlements resulted in mineral producers receiving additional proceeds, audit determinations are necessary to verify that, to the extent the payments were attributable to production, appropriate royalties are paid by the Federal and Indian leaseholders. Over 2,530 of these contract settlements, totaling almost $14 billion, were assigned to the RMP audit division.

On August 27, 1996, a three judge panel of the U.S. Court of Appeals for the District of Columbia Circuit ruled against DOI in a contract settlement case. However, on April 14, 1997, the Sixth Circuit, U.S. Court of Appeals, ruled in DOI's favor on the same general issue. Thus we continue to believe that payments made in settlement of contract disputes are linked to production and should be subject to royalty. Since many cases are nearing the six-year record retention period, contract settlements are an audit priority.

Our audit goal is to achieve a high level of coverage, auditing at least 90 percent of contract settlement proceeds. This is consistent with historical coverage provided by contemporaneous audits.

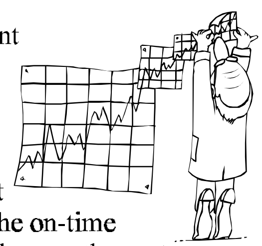
Oil Valuation Rules

The current Federal oil valuation rules rely heavily on posted prices, which many believe substantially understate market value. To respond to these concerns, the MMS published an Advance Notice of Proposed Rulemaking in December 1995 asking for comment through March 1996 on whether postings still represent market value, and suggestions on alternative valuation bases. Based on the comments, the MMS formed a proposed rule drafting team, including representatives from the MMS, the State and Royalty Audit Committee (STRAC), the Navajo Nation, and the Western States Land Commissioners.

The resulting proposed rule, published in the Federal Register on January 24, 1997, and supplemented on July 3, 1997, stated that in true arm's-length situations, oil royalty value will continue to be measured by gross proceeds received by the lessee. When oil is not disposed of at arm's length, the rule proposes that oil value be based on benchmarks. The non-California benchmark value will be the affiliate's arm's-length resale, or the lessee may base value on New York Merchantile Exchange (NYMEX) prices.

Did You Know?

The Royalty Management Program distributed approximately $700 million to individual states in FY 1997 with an on-time disbursement rate of 99.01 percent. The on-time rate has increased steadily over the past 10 years with the exception of FY 1996. The on-time rate in FY 1996 fell to 92.9 percent due to extended Government-wide furloughs.



For affiliated refiners, value would be based on a monthly average of daily NYMEX settled prices adjusted for location and quality differences. The benchmark for California and Alaska oil production would be the Alaska North Slope (ANS) spot price, less appropriate location/quality differentials. Differentials would be derived from published data and information collected by MMS.

The proposed rule also addresses the valuation of RIK oil. It states that value will be tied to non-arm's-length benchmarks: NYMEX outside California and ANS within California. Location differentials would be specified in the RIK contract. Lastly, the proposed rule deletes the option for lessees in non-arm's-length transportation situations to request use of their Federal Energy Regulatory Commission tariffs instead of actual costs.

The supplemental proposed rule responded to concerns that definitions of arm's-length transactions were too restricted. Based on the diverse comments received on the proposed and supplemental proposed rules, MMS published a notice reopening the public comment period until October 22, 1997. The intent of the notice was to obtain comments on a number of alternative valuation procedures suggested by previous commentors. Several workshops involving States, industry, and the public were held during the comment period.

RMP Reengineering

The RMP began its reengineering initiative in FY 1996. The principal objective of this initiative is to design, develop, and implement new core business processes. Reengineering challenges the underlying assumptions upon which the organization is built and fundamentally redesigns systems, processes, and structures around desired outcomes, rather than functions, departments, inputs, and outputs.

Initially, the RMP reengineering effort was focused on its activities ensuring compliance. In March 1997, the RMP expanded the reengineering initiative beyond compliance activities to conduct an indepth reengineering of all RMP core business processes.

Several factors contributed to this decision, including:

- Passage of the Royalty Simplification and Fairness Act (RFSA)
- Royalty Policy Committee recommendations for improved reporting
- Inspector General reports calling for greater operational efficiency and replacement of aging computer systems
- Continued Federal downsizing and public expectations for better service at less cost
- Management recognition that maintaining the status quo with improvements at the margin was not an acceptable long-term strategy

The senior leaders of the RMP gave the following "stretch goals" to the reengineering team as a guide in developing new process approaches for the Program:

- Ensure compliance with applicable laws, lease terms, and regulations for all leases in the shortest time possible, but no later than three years after the due date.
- Provide revenue recipients with access to their money within 24 hours of the due date.

Implicit in these "stretch goals" is revolutionary rather than evolutionary change. In providing this vision of the future, RMP managers still adhered to the agency's strategic direction. The RMP of the future will be:

- Highly integrated
- Fully supported by state-of-the-art technology
- Process centered
- Less costly
- Viewed by customers and competitors as the best

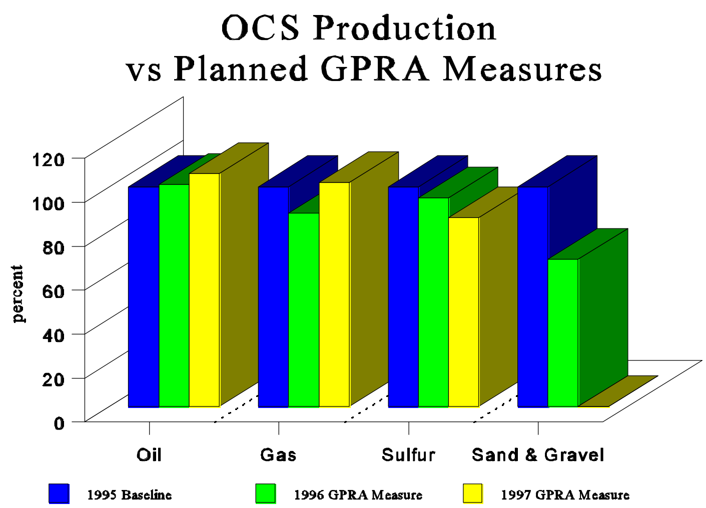
The reengineering team developed a communications strategy to obtain feedback and suggestions from individual employees, companies, and organizations who have a vested interest in the RMP. Agendas are designed to educate our customers about reengineering, to provide information regarding progress, and to obtain input from the audience.

The reengineering initiative will span several years from inception to final implementation. However, improvements will be introduced into the work environment as early in the process as possible. Contractor and reengineering team analysis now underway will ultimately yield final reengineered process designs and plans for future implementation.

Managing for Results

The MMS has identified three goals to help achieve its mission and realize its vision to be recognized as the best minerals resource manager. The first two goals are directly linked to our mission and are based on legislative mandates, the mission statement of the Department of the Interior, stakeholder input, and our experiences. The third goal, our human resources goal, encourages improved performance at all levels of the organization by providing a work environment that supports excellence and productivity.

The MMS developed performance goals and indicators linked directly to our two mission goals and to our human resources goal. These goals and objectives are clear, measurable, and relevant to the fundamental MMS mission. Performance measures are vital and designed to serve program managers.



Measuring Performance

The MMS has developed measurement indicators for each performance objective. These indicators will measure program outcomes using available data and will provide a quantitative assessment of our annual progress towards reaching the long-range goals of the MMS.

While the MMS Strategic Plan describes the long-term course, the Annual Plan defines what will be accomplished in any one year as we proceed on that course. The Annual Plan sets out measurable goals to be accomplished during the fiscal year linked to the budget request using program activity structures.

All of the major program areas within MMS are now developing or refining their performance measures, establishing baseline measurements, or collecting actual measurement data for FY1997. To date, only the performance measure for OCS production activity is available *(see chart).*

Goal 1

Provide for safe and environmentally sound mineral development on the OCS, and ensure that the public receives fair value.

This goal incorporates three primary facets of the MMS mission as mandated in the OCS Lands Act, the National Environmental Policy Act, and related legislation:

- ☞ to make OCS lands available for mineral development to meet national needs;
- ☞ to ensure that any such development is conducted in a safe and environmentally sound manner; and
- ☞ to ensure that fair value is received for making these resources available.

Goal 2

> Provide timely, accurate, and cost-effective mineral royalty collection and disbursement services.

This goal incorporates the MMS mission as primarily mandated by the Federal Oil and Gas Royalty Management Act of 1982. The goal also reflects our compliance with related legislation:

- ☞ OCS Lands Act;
- ☞ Minerals Leasing Act;
- ☞ Indian Self-Determination and Education Assistance; and
- ☞ Royalty Simplification and Fairness Act.

To accomplish this goal, we have selected performance objectives and indicators that relate to the following strategies:

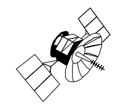
- ☞ assist and encourage royalty payors to submit royalty reports and payments correctly the first time;
- ☞ focus more on preventing, rather than finding, noncompliance;
- ☞ streamline and simplify royalty collection and disbursement processes whenever possible;
- ☞ use modern information tools to improve the royalty collection and disbursement processes; and
- ☞ listen to our stakeholders and involve them in our decision making.

Goal 3

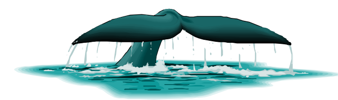
> Encourage a culture that brings out the best in all our employees.

We believe our strength is our employees, who directly influence our ability to accomplish the MMS mission. Our employees are our greatest asset. Therefore, our objectives are to develop, empower, and recognize our workforce.

Did You Know?



MMS, through its Environmental Studies Program, has spent millions of dollars studying and tracking the migratory patterns of whales. In fact, MMS-sponsored research was in the forefront of developing the ability to tag and track the movements of whales by satellites.



Limiting Factors

Many external factors can impact MMS program accomplishments. An example is the impact of a tanker accident and subsequent spill. Even though the vast majority of our OCS production is transported by pipelines, which have an outstanding safety record, oil spills from tankers; e.g., the Exxon Valdez incident, can dramatically impact our program and its planned accomplishments.

Strategies for Achieving Goals

Many of our strategies for achieving the goals are inherent in good management and are focused on improving the way we do business. We continue to look for ways to simplify and streamline our processes and for reengineering opportunities.

We will incorporate a variety of approaches and strategies as we move to implement the goals we have established. We will improve our decisionmaking process, apply modern information systems to improve work quality and service, maintain a high level of scientific expertise and base decisions on high quality science, issue regulations that focus on results rather than processes, and reward innovation.

The MMS strategies for achieving the goals and objectives embodied in MMS's strategic plan include:

- ☞ Improving the decisionmaking process through increased internal coordination and involvement of relevant staff;
- ☞ Ensuring that customers and stakeholders are involved in the decisionmaking process;
- ☞ Assisting and encouraging customers and stakeholders to comply with regulations;
- ☞ Recognizing and responding to the public's concerns;
- ☞ Using modern information tools to improve processes and to receive and disseminate information;
- ☞ Streamlining operations and simplifying processes;
- ☞ Maintaining a high level of scientific and technical expertise;
- ☞ Issuing regulations that focus on results rather than processes; and
- ☞ Providing a consistently high level of customer service.

Validating Performance

A number of efforts are used by the MMS to verify and validate its performance. This evaluation system is a balance of cyclical, indepth appraisals, ongoing self-analysis, and quality improvements of program components. The approach relies on performance measurement and internal and external customer feedback. For all but a few specific measures, baselines have been developed, and the information has been tested and validated. Much of the information for developing the baselines has been collected from existing systems.

Part 2

Financial Statements

Introduction

The financial statements that follow were prepared to report the financial position and results of operations of the MMS, as required by the Chief Financial Officers Act of 1990. While the statements were prepared from accounting records of the MMS, they differ from financial reports prepared by the MMS pursuant to other Office of Management and Budget (OMB) directives addressing MMS's use of budgetary resources. Also, these financial statements should be considered as portraying a component of a larger entity, the Federal Government.

The administrative accounting information provided in the financial statements is obtained from the MMS Advanced Budget Accounting/Control and Information System (ABACIS). The automated system provides for the recording, processing, and reporting of all MMS financial transactions in accordance with interim guidance recommended by the Federal Accounting Standards Advisory Board and agreed to by the Director of OMB and the Comptroller General. Royalty Management accounting information is obtained primarily from the RMP's Auditing and Financial System (AFS) and subsidiary records. Both the ABACIS and the AFS utilize the U.S. Government Standard General Ledger.

The Office of Inspector General (OIG) performed five prior audits of the MMS annual financial statements, covering fiscal years 1996 (Report No. 97-I-445), 1995 (Report No. 96-I-631), 1994 (Report No. 95-I-405), 1993 and 1992 (Report No. 94-I-715), and 1991 (Report No. 93-I-369 -- Combined Statement of Financial Position only). For all five audits, the OIG issued unqualified opinions that the financial statements were fairly presented. The audits also concluded that the MMS internal control structure met established internal control objectives, and that it complied in all material respects with applicable laws and regulations.

Department of the Interior
Minerals Management Service
Combined Statement of Financial Position as of September 30, 1997 and 1996

dollars in thousands

	1997	1996
ASSETS		
Custodial Assets *(managed on behalf of the Federal Government, not available for use in the internal operations)*		
Fund Balance with Treasury-		
Royalty Collections (Note 3)	$ 442,836	$ 389,966
Accounts Receivable, Net (Note 5)	386,991	244,263
Escrow Investments (Note 4)	1,667,348	1,537,531
Total Custodial Assets	2,497,175	2,171,760
Operating Assets *(relating to internal operations, funded by Congressional appropriations)*		
Current Assets		
Fund Balance with Treasury (Note 3)	76,033	81,746
Cash and Other Monetary Assets	9	49
Accounts Receivable: (Note 5)		
Public	361	1,663
Due from Federal Agencies	2,870	153
Total Current Assets	79,273	83,611
Property, Plant, and Equipment (Net of Depreciation) (Note 6)	17,212	13,251
Total Operating Assets	96,485	96,862
TOTAL ASSETS	$2,593,660	$2,268,622

The accompanying notes are an integral part of these statements.

Department of the Interior
Minerals Management Service
Combined Statement of Financial Position as of September 30, 1997 and 1996
dollars in thousands

	1997	1996
LIABILITIES AND NET POSITION		
LIABILITIES		
Custodial Liabilities (offsets Custodial Assets)		
Pending Royalty Distributions (Note 7)	$ 829,827	$ 634,229
Distribution of Escrow Investments	1,667,348	1,537,531
Total Custodial Liabilities	2,497,175	2,171,760
Operating Liabilities *(relating to internal operations)*		
Liabilities Covered by Budgetary Resources		
Liabilities to the Public:		
Accounts Payable to the Public	8,118	5,380
Accrued Payroll and Benefits (Note 7)	4,933	4,534
Total Liabilities to the Public	13,051	9,914
Liabilities to Federal Agencies:		
Accounts Payable	2,351	5,556
Advances from Other Agencies	2,223	0
Receipts Transferable to Treasury	9	49
Total Liabilities to Federal Agencies	4,583	5,605
Total Liabilities Covered by Budgetary Resources	17,634	15,519
Liabilities Not Covered by Budgetary Resources		
Unfunded Payroll Costs (Note 7)	9,698	8,725
Total Liabilities Not Covered by Budgetary Resources	9,698	8,725
Total Operating Liabilities	27,332	24,244
Total Liabilities	$2,524,507	$2,196,004
Net Position		
Unexpended Appropriations (Note 8)	61,639	68,092
Cumulative Results of Operations (Note 8)	7,514	4,526
Total Net Position	69,153	72,618
TOTAL LIABILITIES AND NET POSITION	$2,593,660	$2,268,622

The accompanying notes are an integral part of these statements.

Department of the Interior
Minerals Management Service
Statement of Net Cost from Operations
for the Years Ended September 30, 1997 and 1996
dollars in thousands

	1997	1996
Expenses		
Operating Expenses (Note 11)	$227,103	$202,120
Other Expenses		
Depreciation	2,246	1,771
Interest Expense	92	165
Retirement & Post Benefit Expense (Note 13)	17,322	0
Other Expense	973	564
Total Other Expenses	20,633	2,500
Total Expenses	247,736	204,620
Revenues/Receipts		
Other Revenues		
Reimbursement from other Federal Agencies	20,220	2,973
Imputed Financing Source (Note 13)	17,322	0
Other Revenue	41,068	15,400
Total Revenues/Receipts	78,610	18,373
Net Cost of Operations	$169,126	$186,247

The accompanying notes are an integral part of these statements.

Department of the Interior
Minerals Management Service
Statement of Changes in Net Position
for the Years Ended September 30, 1997 and 1996
dollars in thousands

	1997	1996
Change in Net Position		
Net Cost of Operations	$(169,126)	$(186,247)
Appropriation Expensed	174,273	186,286
Net Results of Operations	5,147	39
Net Change from Operations	5,147	39
Other Changes in Net Position		
Increase (Decrease) in Appropriated Capital	(12,573)	(33)
Increase (Decrease) in Invested Capital	3,961	829
Net Other Changes in Net Position (Note 12)	(8,612)	796
Net Change in Net Position	(3,465)	835
Net Position - Beginning of Year	72,618	71,783
Net Position - End of Year	$ 69,153	$ 72,618

The accompanying notes are an integral part of these statements.

Minerals Management Service

Statement of Custodial Activity
for the Years Ended September 30, 1997 and 1996
dollars in thousands

	1997	1996
Collections on Behalf of the Federal Government (Note 9)		
Mineral Lease Collections		
Rents and Royalties	$4,891,647	$4,264,540
Offshore Lease Sales	1,338,559	714,764
Other	48,588	1,078
Total Mineral Lease Collections	6,278,794	4,980,382
Earnings on Escrow Investments		
Amortized Discount	45,876	39,970
Interest Earned, Federal	40,181	41,044
Total Investment Earnings	86,057	81,014
Total Collections	6,364,851	5,061,396
Less: Transfers on Behalf of the Federal Government (Note 11)	(6,182,164)	(4,664,736)
Untransferred Collections	(182,687)	(396,660)
Total Transferred & Untransferred Collections	(6,364,851)	(5,061,396)
Excess of Collections over Transfers	$ 0	$ 0

The accompanying notes are an integral part of these statements.

Minerals Management Service
Statement of Budgetary Resources
for the Year Ended September 30, 1997
dollars in thousands

	1997
Budgetary Resources Made Available	
Budget Authority	$163,435
Unobligated Balances - Beginning of Period	10,483
Reimbursements and Other Income	80,390
Adjustments	(205)
Total, Budgetary Resources Made Available	254,103
Status of Budgetary Resources:	
Obligations Incurred (gross)	243,329
Unobligated Balances - End of Period	3,175
Unobligated Balances - Not Available	7,599
Total, Status of Budgetary Resources	254,103
Obligations Incurred, Net	161,436
Obligated Balance Transferred	0
Obligated Balance - Beginning of Period	71,262
Less: Obligated Balance - End of Period	65,263
Total Outlays	$167,435

The accompanying notes are an integral part of these statements.

Part 3
Notes to Financial Statements

Notes to Financial Statements

Minerals Management Service
Combined Financial Statements For
Fiscal Years Ending September 30, 1997 And 1996

Note 1. Significant Accounting Policies

Basis of Presentation

These financial statements were prepared to report the financial position and results of operations of the Minerals Management Service (MMS), as required by the Chief Financial Officers Act of 1990. They were prepared primarily from the accounting records of the MMS in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin No. 94-01, and also, as appropriate, with the OMB Statement of Federal Financial Accounting Concepts Number 2, "Entity and Display." The net position information in the Statement of Financial Position is based partly on U.S. Department of the Treasury (Treasury) reports.

Significant MMS accounting policies are summarized in this Note. These financial statements differ from the financial reports prepared by the MMS pursuant to other OMB directives that are used to monitor and control MMS's use of budgetary resources.

Reporting Entity

The MMS was created on January 19, 1982, by Secretarial Order No. 3071, under authority of Section 2 of Reorganization Plan No. 3 of 1950 (64 Stat. 1262). On May 10, 1982, by Secretarial Order No. 3071, Amendment No. 1, all Outer Continental Shelf (OCS) leasing responsibilities of the Department of the Interior were consolidated within MMS under Section 2 of Reorganization Plan No. 3 of 1950. Amendment No. 2, dated May 26, 1982, set forth the basic organizational structure for the 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 the MMS.

The MMS has principal responsibility for the offshore leasing program, leasing management, 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, the 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.

Basis of Accounting

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

- Statements of Federal Financial Accounting Standards (SFFAS). These statements reflect the accounting principles, standards, and requirements recommended by the Federal Accounting Standards Advisory Board and approved by the Comptroller General of the United States, the Director of OMB, and the Secretary of the Treasury.

- Interpretations of SFFAS.

- Form and content requirements for financial statements as presented in OMB Bulletin Nos. 97-01 and 94-01 (Form and Content of Agency Financial Statements), and OMB Statement of Federal Financial Concepts No. 2 (Entity and Display).

- The accounting principles and standards contained in Departmental and Bureau accounting policy and procedures manuals, and related guidance.

- Accounting principles published by authoritative standard-setting bodies and other authoritative sources, in the absence of other guidance in the first four parts of this hierarchy.

The statements are presented on a combination of the cash and the accrual bases of accounting. The accrual basis of accounting recognizes the significance and accountable aspects of transactions as they occur. Billed but uncollected mineral lease royalties (receivables) are not recognized as collections because these receivables are subject to significant adjustments prior to collection, and the actual collections resulting from these receivables cannot be reliably estimated. Accordingly, conservative accounting principles require royalty collections to be disclosed on the cash basis instead of the accrual basis of accounting on the Statement of Custodial Activity. However, the balance of billed receivables relating to royalty collections is disclosed on the Statement of Financial Position as a liability (with an offsetting receivable) because of the significant value of the liability. Lack of disclosure of this information would significantly distort the potential liability of MMS to recipients of royalty collections. Because of the different accounting bases for royalty collections, the Statement of Financial Position and the Statement of Custodial Activity do not reconcile.

Certain MMS financial activities interact with and depend on the financial activities of the centralized management functions of the Federal Government. These activities are performed for the benefit of the whole Federal Government, and include public debt and employee retirement, life insurance, and health benefit programs. Employee retirement, life insurance, and health benefit costs, along with an assigned (imputed) financing source for these costs, are included in the MMS financial statements. Prior to FY 1997, employee benefit cost was not reported at the agency level. The detail of these assigned benefit costs is provided in Note 13. Public debt activities that are performed for the benefit of the Federal Government as a whole are not included in these financial statements.

Other Financing Sources and Revenues

The primary financing source for the operation of the MMS is its annual congressional appropriation. For FY 1997, the principal MMS appropriation account was 1471917. Funds for specific purposes were also appropriated in accounts 147/81917, 14X1917, 14X8370, 14X5003, 14X5243, and 14X5248. Appropriated funds are used for operating and capital expenditures of the MMS. Additional amounts are obtained through reimbursements for services performed for other Federal Agencies. Appropriations are recognized as revenues at the time they are used to pay program or administrative expenses. Appropriations expended for capitalized property and equipment are recognized as expenses as the assets are consumed in operations.

The MMS's FY 1997 appropriation allows for the retention of revenues, in an amount not to exceed $41 million, to be used for the development of the Technical Information Management System (TIMS). The TIMS is a comprehensive ADP system for evaluating OCS resources. The revenues result from additions to receipts caused by increased rental rates for offshore leases, rate increases to fee collections for OCS administrative activities, and additional fees for OCS administrative activities established after September 30, 1993. The revenues are credited to the appropriation and remain available until expended.

The MMS Royalty Management Program (RMP) collects 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. The amounts collected, not including billed receivables (see Basis of Accounting discussion in this Note), are disclosed in the Statement of Custodial Activity as Collections on Behalf of the Federal Government. Corresponding amounts are also disclosed as Transfers on Behalf of the Federal Government. None of the royalties and other receipts collected by the MMS are retained for use by the MMS.

Fund Balances With the Treasury and Cash

Federal Government cash is administered on an overall consolidated basis by the Treasury. The “Fund Balance with Treasury” line in the Entity Assets Section of the Statement of Financial Position represents the right to draw on the Treasury for allowable expenditures relating to the MMS appropriation. The “Cash and Other Monetary Assets” line represents the aggregate corpus of MMS impressed funds. The “Fund Balance with Treasury” line in the Custodial Assets Section represents royalty collections received by the MMS but not yet disbursed to recipients.

Investments in Securities

The MMS investments in Federal Government securities are nonmarketable - market based, and are reported at cost net of amortized premiums or discounts. Additional information on MMS investments is provided in Note 4.

Property, Plant, and Equipment

Property, plant, and equipment are valued at historical cost. Property, plant, and equipment are capitalized if the initial acquisition cost is $5,000 or more and the estimated useful life is two years or greater (excluding ADP software). Depreciation is recorded using the straight-line method based on useful lives ranging from 5 to 36 years. During FY 1997, adjustments were made to equipment balances reflecting changes to equipment cost bases resulting from reclassifications, upgrades, and revaluations of existing equipment (see Note 12). Additional information on MMS property, plant, and equipment is provided in Note 6.

Operating Materials and Supplies

The MMS operating materials and supplies primarily consist of office supplies, library materials, and fuel charges. It is assumed that all operating materials and supplies purchased during the year were consumed during the year. Accordingly, no net value is applicable to these items.

Liabilities

Operating Liabilities of the MMS represent amounts likely to be paid by the 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 unfunded liabilities and there is no certainty that the appropriation will be enacted. The MMS liabilities arising from other than contracts can be abrogated by the Government acting in its sovereign capacity.

The MMS also recognizes custodial liabilities for Pending Transfers of Royalty Collections and Receivables and Pending Transfers of Escrow Investments. Pending Transfers of Royalty Collections and Receivables represent amounts owed to royalty recipients, and correspond to the total of the asset accounts: “Fund Balance with Treasury - Royalty Collections” and “Accounts Receivable.” Pending Transfers of Escrow Investments primarily represent amounts relating to disputed leases held in escrow pending resolution of the disputes. They correspond to amounts included in the asset account: “Escrow Investments.” Additional information on MMS liabilities is provided in the Basis of Accounting section of this Note and in Note 7.

Contingencies

The MMS is party to a lawsuit where monetary amounts are being sought from the Federal Government. The plaintiffs claim that enactment of the Outer Banks Protection Act in 1990 constituted a material breach of leases they held in North Carolina pursuant to the Outer Continental Shelf Lands Act, and are seeking damages of $160 million. The Court of Federal Claims has ruled in favor of the plaintiffs on the breach of contract claims; however, the Government appealed this ruling to the Federal Circuit Court. The Federal Circuit Court should make a ruling in 1998. The MMS can make no estimate at this time as to the final disposition of the appeal or as to any ultimate settlement that may be required. Amounts awarded to the plaintiffs, if any, will be paid by the Judgment Fund administered by the Department of Justice and so will not be paid from MMS operating funds.

The MMS has a number of other claims and lawsuits pending against it. In the opinion of management and the Office of the Solicitor, Department of the Interior, the resolution of these claims and lawsuits will not materially affect MMS's financial position or operations. Therefore, no provision for these claims and lawsuits has been made in the accompanying statements.

Public Law 101-510 requires the MMS to cancel its appropriations five years after the expiration of the appropriations. Any required disbursements against those appropriations after they are canceled must be made out of the current year's appropriation. As of September 30, 1997, the MMS had a balance of $3,740,795 in unliquidated obligations against canceled appropriations that represents potential liabilities against current year appropriations.

Annual, Sick, and Other Leave

Annual leave earned but not taken is accrued in the accounting system and presented in the financial statements. 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 fund unused earned annual leave, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expended when used but are not accrued when earned.

Pension and Retirement Plans

Employees of the MMS participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS), to which the MMS makes matching contributions. These statements do not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to MMS employees, since these data are only reported in total by the Office of Personnel Management. On January 1, 1987, FERS went into effect pursuant to Public Law 99-335. Employees hired after December 31, 1983, are automatically covered by FERS, while employees hired prior to that date could elect either FERS or CSRS coverage. One of the primary differences between FERS and CSRS is that FERS offers a savings plan to which MMS is required to contribute one percent of basic pay and match employee contributions up to an additional four percent of basic pay. The MMS's contributions for FY 1997 to CSRS and FERS were $4,419,167 and $3,389,292, respectively.

These financial statements also reflect CSRS or FERS accumulated plan benefits and unfunded retirement liabilities, if any. These amounts are calculated and provided to MMS by the Office of Personnel Management. Assigned (imputed) retirement and post-employment benefit costs are provided in Note 13.

Note 2. Significant Accounting Policies Relating to the Royalty Management Program

Section 8g Settlement

The Outer Continental Shelf (OCS) Lands Act Amendment of 1985 (85 Amendment), provided for the settlement of OCS lease ownership disputes between the Federal Government and various coastal States. The 85 Amendment required annual payments over the next 15 years to the affected States. The payments are made before April 15 each year. The 85 Amendment stated the payments are funded from revenues derived from OCS leases.

The annual settlement payments for FY 1997 were $65 million and for FY 1996, $45.5 million. As of the end of FY 1997, the outstanding liability to the States was $260 million. The remaining schedule of payments is as follows:

Fiscal Year	Amount($ in millions)
1998	$65.0
1999	65.0
2000	65.0
2001	65.0

Accounting for the Royalty-in-Kind (RIK) Program

Federal Government and Indian oil and gas leases are issued with a provision that the lessor may elect to receive the royalty amount in product rather than in value. The RMP currently has eight RIK contracts (two onshore and six offshore) for Federal leases. Five RIK contracts were terminated during FY 1997. These contracts were established in accordance with Federal law (most notably, the Mineral Leasing Act of 1920; the OCS Lands Act of 1953; and the Emergency Petroleum Allocation Act of 1973) to provide small refiners a constant source of product to continue their operations. Operators are required to report the entitled amount of product to be delivered to these designated refiners and RMP then issues bills to the refiners for the payments.

In FY 1997, refiners were billed $475.9 million for RIK transactions. Contracts with the refiners allow assessing an administrative fee to cover RMP's cost of managing the RIK program. In FY 1997, RMP billed $920,095 in administrative fees. In addition to paying administrative fees, refiners post both a 30-day cash surety and a surety (estimated payment) drawn against a financial institution (i.e., a bond or letter of credit) in an amount equal to 99 days' entitlement for their contract. These sureties are posted at the time of contract execution and are reviewed/adjusted monthly to ensure adequacy of coverage. As of September 30, 1997, surety coverage for the eight active RIK contracts consisted of $29.5 million in cash surety and $99.8 million in one bond and seven letters of credit. Surety coverage for the five terminated RIK contracts consisted of $36.7 million in five letters of credit. An additional letter of credit for $1.8 million is being held for an appealed RIK-related billing issue.

Indian Nonstandard Lease Responsibilities

The MMS accepted responsibility in March 1988 to account for Indian leases issued per the provisions of the Indian Mineral Development Act of 1982 (25 U.S.C. 2101 et seq.). These leases are negotiated directly between individual Indian tribes and industry. The Indian leases also contain unique terms or conditions that have to be accounted for manually. The MMS classifies Indian nonstandard leases into three major groups:

- Joint Venture Leases—Leases with another party to share in the development costs and revenues of a property or group of properties;

- Net Profit Share Leases—Leases with another party to share in the revenues of a property or properties, usually after deducting operating expenses;

- Royalty Leases with unusual terms or conditions—Leases with variable or conditional royalty rates, bonus or penalty payment terms, alternative methods or reporting frequencies.

OCS Refund Requests

Refund requests from payors, presumably due to previous overpayments on OCS leases, total $146.4 million. These requests must be verified by MMS and then forwarded to Congress for 30 days for review. If no Congressional objection is raised, the refund or recoupment is automatically approved. The Royalty Simplification and Fairness Act of 1996 repealed all refund requirements of the OCS Lands Act, Section 10. This repeal will affect refunds for OCS overpayments after the Act’s implementation.

Alabama Escrow

A judgement against the MMS was issued May 18, 1994, by the U.S. District Court for the Southern District of Alabama, Southern Division. The judgement directed the MMS to pay to the Court Registry the Federal portion of royalties for natural gas production from OCS Block 823. The Court's order was vacated on August 20, 1996, and the original lawsuit was dismissed as of August 27, 1996.

A total of about $39.1 million was paid by the Court Registry to RMP on November 19 , 1996.

Note 3. Fund Balances with Treasury

dollars in thousands

Fund Balances with Treasury	Obligated	Unobligated: Available	Unobligated: Restricted	Total
Appropriated Funds	$65,259	$3,175	$7,599	$76,033
Royalty Collections		442,836		442,836
Total Funds with Treasury	$65,259	$446,011	$7,599	$518,869

Note 4. Investments

dollars in thousands

	Cost	Market Value	Amortization Method	Amortized (Premium) Discount	Net Investment
Escrow Investment	$1,621,472	N/A	Straight Line	$45,876	$1,667,348

Section 7 of the Outer Continental Shelf (OCS) Lands Act allows for receipts from OCS leases having boundary disputes to be invested in Federal Government securities. The current investment amount is due to an ongoing boundary dispute with the State of Alaska dating back to 1979. The principal portion of the Alaska investment is $443 million and the earned interest is $1.066 billion. The funds are continually reinvested and will be disbursed when the boundary dispute is resolved.

A Special Master was appointed by the Court to make findings and recommendations. The Master issued his recommendations in April 1996, and oral arguments were held before the Court in February 1997. The U. S. Supreme Court published its decision in the case on June 19, 1997, ruling in favor of the United States on all but two questions. The Federal Government was granted all but approximately $4 million of $1.6 billion in monies escrowed from leasing these disputed lands during the period of litigation. A request for rehearing was filed by the State and subsequently denied by the Court. The parties are presently preparing a implementation plan for Court review and approval. A final decree in the case is expected by summer 1998, at which time the escrowed monies will be disbursed.

Also, the MMS is required by regulation to invest the 1/5 OCS bid amounts from the apparent high bidders for all OCS lease sales. The 1/5 bid investment represents less than seven percent of the total investment amount. 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.

Note 5. Accounts Receivable

General Operations

Accounts receivable relating to general operations consist primarily of amounts due to the MMS from other agencies in connection with various interagency agreements, travel advances to MMS employees, and refunds due from MMS vendors.

Royalty Management

The Custodial Accounts Receivable for FY 1997 includes estimates for interest on billed amounts that were not included in the figures for FY 1996. Included in the FY 1997 figures is an increase to Allowances to reflect the value of estimated adjustments to be made to receivables. The FY 1996 amounts were not restated for these changes.

The Federal Oil and Gas Royalty Management Act (FOGRMA) of 1982 requires reports and payments of royalties by the end of the month following the month in which products are sold. The RMP receivables represent RMP issued royalty-related invoices and any deferred bonus amounts. The amount of RMP receivables is also included in Pending Transfers in the Custodial Liabilities Section of the Statement of Financial Position. As explained in Note 1, accounts receivable relating to royalty collections are not disclosed in the Statement of Custodial Activity.

Recognition of Delinquent Accounts Receivable

Approximately $330 million of the $387 million RMP net receivables as of September 30, 1997, are considered delinquent. Of the $330 million, about $290 million is in adjudication and the amount collectible is uncertain. Delinquent receivables comprise bills issued for:

- Late payment of royalty reports - payments received after due date;
- Late payment of bills - payments received after due date;
- Nonpayment of royalty reports - payments not received; and
- Various types of assessments, e.g., erroneous reporting or valuation issues.

Interest is calculated at statutory rates tied to the Internal Revenue Code by FOGRMA. The estimated net amount of interest due for FY 1997 is about $222,803,965. Generally, the outstanding billed receivables, accumulated interest and one additional year of interest are covered by certificates of deposit, bonds, or letters of credit until all appeal processes allowed by Federal law, are exhausted.

The current surety value is $606 million; $178 million covering invoice values and $428 million covering the potential interest value on the invoices. Some of the amounts owed are shareable with various States and Indian tribes and Indian allottees, with the remainder owed to miscellaneous receipt funds.

Allowance for Amounts to be Written Off

The amounts estimated to be written off for royalty payments are based on the most recent fiscal year's experience in collecting accounts receivable. Since the RMP has no appropriation or other account to actually offset the uncollectible receivables, the RMP's method for offsetting these amounts is to credit the same receivable.

Receivables actually written-off represent only a small fraction of the total receivables because the majority of receivables are backed by sureties. The largest portion of the allowance includes an estimate of the adjustments that will be made to correct errors and to reflect adjustments.

Summary of Accounts Receivable

as of September 30, 1997

dollars in thousands

Type of Receivable	Royalty Management	Operations	Total
Custodial Receivables			
Governmental	$727,056		$727,056
Allowance for Estimated:			
Uncollectibles	(115)		(115)
Adjustments	(339,950)		(339,950)
Net Custodial Receivables	$386,991		$386,991
Operating Receivables			
Public		$ 361	361
Governmental		2,870	2,870
Net Operating Receivables		3,231	3,231
Net Receivables	$386,991	$3,231	$390,222

Note 6. Property, Plant, and Equipment

dollars in thousands

Class of Fixed Assets	Depreciation Method	Service Life	Acquisition Value	Accumulated Depreciation	Net Book Value
Vehicles	Straight-Line	5-10 Years	$ 440	$ 270	$ 170
Office Equipment	Straight-Line	5-36 Years	5,154	1,814	3,340
ADP	Straight-Line	5-20 Years	21,894	8,729	13,165
Other Fixed Assets	Straight-Line	5-20 Years	804	267	537
Totals			$28,292	$11,080	$17,212

Note 7. Other Liabilities

dollars in thousands

	General Operations		Royalty Management		Total
	Current	Noncurrent	Current	Noncurrent	
Other Liabilities Covered by Budgetary Resources					
Governmental: Accrued Payroll	$ 4,933				$4,933
Other Liabilities Not Covered by Budgetary Resources					
Pending Royalty Distributions			$ 811,001	$ 18,826	829,827
Escrow Investments[1]			1,667,348		1,667,348
Governmental: Unfunded Annual Leave	9,698				9,698
Totals	$14,631		$ 2,478,349	$ 18,826	$ 2,511,806

[1]The settlement of the boundary dispute for which 99 percent of the escrow investment was established (see Note 4) is not determinable. Accordingly, the entire investment is considered current.

Note 8. Net Position

dollars in thousands

	FY 1997	FY 1996
Unexpended Appropriations		
Unobligated		
Available	$ 3,175	$ 6,547
Unavailable	7,599	3,937
Undelivered Orders	50,865	57,608
Total Unexpended Appropriations	61,639	68,092
Invested Capital	17,212	13,251
Future Funding Requirements	(9,698)	(8,725)
Cumulative Results of Operations	7,514	4,526
Total Net Position	$69,153	$72,618

Note 9. Collections on Behalf of the Federal Government

dollars in thousands

	FY 1997	FY 1996
Collections on Behalf of the Federal Government		
Mineral Lease Collections		
Rents and Royalties	$4,891,647	$4,264,540
Offshore Lease Sales	1,338,559	714,764
Miscellaneous Collections	48,588	1,078
Total Royalties Collected	6,278,794	4,980,382
Amortized Discount	45,876	39,970
Interest Earned, Federal	40,181	41,044
Total Earnings on Escrow Investments	86,057	81,014
Total Collections	$6,364,851	$5,061,396

Royalty Collections and Escrow amounts are not available for use by the MMS. Mineral lease rents and royalties represent amounts paid by mineral lessees per the terms of the lease. Royalties are to be paid monthly for the prior month's production and sales of the minerals. Rents are paid once a year at the beginning of the lease year until production begins or the lease is terminated.

Offshore lease sales are the amounts collected from the bonus and first year rental on OCS leases. Miscellaneous collections result from money received in error from mineral industry payors. The FY 1997 Miscellaneous Collections includes the $39.1 million from the U.S. District Court Registry for the Alabama Escrow settlement. Also included in the FY 1997 figure is an $8 million adjustment to the Land and Water Conservation Fund from the National Park Service.

The large increase in the Offshore Lease Sale amounts resulted from continued interest in the Deep Water Royalty Relief regulations which spurred attention to the Gulf of Mexico. The 1,001 leases issued in the Central Gulf sale topped last year’s record by about 10 percent for the largest number of leases let in any OCS sale. The Western Gulf of Mexico sale set a record for the number of bids received.   There was also a small OCS sale in the Cook Inlet area of Alaska. This was the second consecutive year for leasing activity in the Alaska offshore areas.

The increase in the Rents and Royalties amount is the result of increased oil and gas prices in FY 1997.

Note 10. Interest

The MMS incurs interest expense primarily for delayed disbursements of royalties to States and Indians. The FOGRMA, as interpreted by the solicitor and various courts, requires the RMP to disburse all States shareable monies the month following receipt of the funds and by the last day of the month received for Indian monies. Any monies not disbursed within the prescribed time frame accrue interest until disbursement is made.

The MMS paid $91,237 in interest payments in FY 1997 and $163,520 in interest payments in FY 1996. Most interest results from incorrect reporting from industry. The $72,283 difference between FY 1997 and FY 1996 resulted mainly from the Federal employees' furlough during December 1995 and January 1996.

The MMS also pays a small amount of interest in the form of late payment penalties to vendors required under the Prompt Payment Act. Late payment penalties totaling $776 and $1,257 were paid in FY 1997 and FY 1996, respectively.

Note 11. Detail of Operating Expenses and Royalty Collection Transfers

dollars in thousands

Operating Expenses by Object Classification

	FY 1997	FY 1996
Personnel Compensation and Benefits	$ 116,204	$111,943
Employee Benefit Cost [1]	17,322	0
Travel and Transportation	3,817	2,798
Rents, Communications, and Utilities	12,243	12,002
Printing and Reproduction	11,582	487
Contractual Services [2]	72,828	63,445
Supplies and Materials	2,920	3,876
Noncapitalized Equipment	7,509	7,569
Unfunded Expenses	973	564
Interest Expense	92	165
Depreciation	2,246	1,771
Total Expenses by Object Class	$247,736	$204,620

[1] Prior to FY 1997, employee benefit cost was not reported at the Agency level.

[2] The major portion of contractual services consists of operation and maintenance contracts for RMP computer systems, and contracts for various environmental assessment studies.

Transfers of Royalty Collections by Recipient

	FY 1997	FY 1996
U.S. Treasury General Fund	$ 3,820,661	$2,601,616
National Park Service	1,046,980	1,046,906
State Shares of Mineral Receipts	684,908	546,892
Bureau of Reclamation	442,985	350,264
Indian Tribes and Agencies	53,954	41,218
Other Federal Agencies	29,553	20,574
Other Transfers	62,123	41,866
MMS Offshore Program	41,000	15,400
Total Transfers on Behalf of the Federal Government	$ 6,182,164	$4,664,736

Note 12. Non-Operating Changes

dollars in thousands	FY 1997	FY 1996
Increases:		
Transfers In		
Warrants	$ 156,955	$ 182,312
Restorations	6,480	6,400
Equipment Additions	6,283	2,358
Total Increases	169,718	191,070
Decreases:		
Transfers Out		
Accrued Expenditures	174,300	185,592
Withdrawals	1,708	3,153
Equipment:		
Depreciation	2,246	1,771
Disposals	1,954	463
Total Decreases	180,208	190,979
Other Adjustments:		
Equipment Adjustment, Net	1,878	704
Net Non-Operating Changes	$ (8,612)	$ 795

Note 13. Assigned Retirement and Post-Employment Benefit Cost

Prior to FY 1997, Department of the Interior Bureaus did not report an assigned (imputed) cost or assigned financing source for retirement and post-employment benefits borne by the Office of Personnel Management. Because of new guidance issued by the Federal Accounting Standards Advisory Board, effective in FY 1997, these assigned costs and financing sources will now be recorded and reported. This will allow Bureaus to more accurately reflect the benefit costs created by Bureau operations. The following table details the assigned costs incurred by the MMS for retirement and post-employment benefits.

dollars in thousands

	Total Amount of Base Salary or Accrued Benefits	Assigned Costs		Total Costs	
		Percentage	Amount	Percentage	Amount
Civil Service Retirement System Pensions	$ 55,959	10.20%	$5,708	17.20%	$9,625
Civil Service Retirement System Offset Pensions	2,943	7.00%	206	14.00%	412
Federal Employees Retirement System	31,344	0.00%	0	10.70%	3,354
Retirement Life Insurance	75,066	0.02%	15	0.02%	15
Retirement Health Benefits	1,571 employees (yearly average) @ $2,493.00 per employee		3,916		3,916
			$9,845		$17,322

Part 4

Supplemental Schedules

Schedule 1

Minerals Management Service

FY 1997 Obligations by Budget Activity/Subactivity and Major ExpenseCategory

dollars in thousands

	Salaries / Benefits	Travel	Services	Equipment	All Other	Total
	Royalty and Offshore Minerals Management (ROMM)					
	OCS Lands					
Leasing & Environ. Program	$13,126	$582	$12,601	$123	$218	$26,650
Resource Evaluation	14,044	339	2,748	187	123	17,441
Regulatory Program	17,751	562	8,190	444	282	27,229
Information Mgmt. Program	6,151	233	6,416	6,195	571	19,566
Offshore Mgmt.	4,930	390	918	234	683	7,155
Total	56,002	2,106	30,873	7,183	1,877	98,041
	Royalty Management					
Valuation & Operations	16,514	498	14,379	2,309	1,023	34,723
Compliance	23,750	1,045	8,182	665	450	34,092
Interest on Late Disbursements	0	0	0	0	91	91
Total	40,264	1,543	22,561	2,974	1,564	68,906
	General Administration					
Executive Direction	2,225	101	250	150	108	2,834
Policy & Mgmt Improvement	2,971	91	757	84	31	3,934
Admin Operations	10,574	230	851	354	295	12,304
General Support Services	788	22	2,132	164	11,126	14,232
Total	16,558	444	3,990	752	11,560	33,304
Total ROMM	112,824	4,093	57,424	10,909	15,001	200,251
	Oil Spill Research (OSR)					
Oil Spill Research	1,548	81	5,959	46	300	7,934
Total OSR	1,548	81	5,959	46	300	7,934
Total MMS	$114,372	$4,174	$63,383	$10,955	$15,301	$208,185

Schedule 2

Minerals Management Service

Summary Of Royalty Transferred to Other Federal Agencies

dollars in thousands

	1997	1996
U.S. Treasury	$3,820,661	$2,601,616
National Park Service	1,046,980	1,046,906
Bureau of Reclamation	442,985	350,264
U.S. Forest Service	22,770	15,649
U.S. Fish & Wildlife Service	4,942	4,102
Department of Commerce	939	0
Bureau of Land Management	902	823
TOTAL	$5,340,179	$4,019,360

Minerals Management Service

Summary of Royalty Disbursements to States

dollars in thousands

State[1]	1997	1996
Alabama	$14,038	$11,010
Alaska	22,846	14,177
Arizona	48	17
Arkansas	1,000	920
California	52,887	50,945
Colorado	37,333	34,481
Florida	16	37
Idaho	2,201	2,144
Illinois	68	80
Kansas	1,329	1,094
Kentucky	123	112
Louisiana	27,449	24,066
Michigan	712	702
Minnesota	13	6
Mississippi	1,676	1,097
Missouri	1,273	1,206
Montana	20,361	20,258
Nebraska	16	14
Nevada	5,706	5,751
New Mexico	188,660	118,309
North Dakota	3,894	2,370
Ohio	153	166
Oklahoma	2,137	1,716
Oregon	42	63
Pennsylvania	21	21
South Dakota	566	633
Texas	26,038	21,532
Utah	34,291	34,090
Virginia	85	90
Washington	818	469
West Virginia	326	197
Wisconsin	0[1]	1
Wyoming	238,782	199,118
TOTAL	$684,908	$546,892

[1] In 1997, the States of Georgia, North Carolina, Tennessee, and Wisconsin received royalty disbursements, but in amounts less than $1,000, which do not show on this schedule.

Schedule 4

Minerals Management Service

Royalty Collections Transferred to Bureau of Indian Affairs for Distribution to Indian Tribes

dollars in thousands

Tribe	1997	1996
Alabama-Coushatta	$10,969	$3,887
Assiniboine-Sioux	415	393
Blackfeet	175	20
Cherokee, Choctaw, Chickasaw	276	298
Cheyenne-Arapaho	469	322
Chickasaw, Choctaw	268	194
Chilocco Indian School	2	3
Chipewa-Cree	201	142
Choctaw	54	45
Creek	1	21
Creek-Tholopthlocco (1936)	15	13
Creek Nation Escrow	12	0
Crow	60	59
Jicarilla Apache	0	22
Navajo	133	19
Otoe/Missouri	2	0
Pawnee	2	2
Ponca	1	0
Sac & Fox	5	4
Seminole	6	6
Shoshone and Arapahoe	11,222	8,673
Shoshone Bannock	43	0
Southern Ute	123	33
Ute (Northern Ute)	5,989	5,740
Ute (Mountain Ute)	3,147	1,908
Wichita, Caddo, Delaware	2	2
Total Tribal Amounts	$33,592	$21,806

Schedule 5

Minerals Management Service

Royalty Collections Transferred to Bureau of Indian Affairs For Distribution to Indian Agencies

dollars in thousands

Allottee Name	1997	1996
Anadarko	$ 5,207	$ 4,144
Blackfeet	37	44
Cheyenne River	9	11
Concho	4,595	3,777
Crow	49	48
Ft. Belknap	83	56
Ft. Berthold	286	268
Ft. Peck	1,007	1,102
Michigan	2	2
Muskogee	1,522	2,295
Muskogee (Cherokee)	4	13
Navajo	3,650	2,390
Pawnee	441	327
Shawnee	1,794	1,166
Southern Ute	552	657
Turtle Mountain	6	10
Uintah and Ouray	1,783	1,966
Unidentified[1]	(864)	918
Wind River	184	206
Wind River (Amoco)	13	2
Total Allotted	$20,360	$19,402

[1]The Unidentified amount represents the net funds transferred to BIA for which MMS does not know the identity of the Agency or Tribe. The FY 1997 negative value resulted from the identification and transfer of the FY 1996 funds balance.