Financial Statements, Notes to Financial Statements, and other Required Accountability Report Information

COMPLIANCE WITH LEGAL AND FINANCIAL REQUIREMENTS

The following provides information on OSM's compliance with:

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

Federal Managers' Financial Integrity Act (FMFIA)
The FMFIA requires agencies to annually provide a statement of assurance of the effectiveness of internal controls in achieving reliability of financial reporting, compliance with applicable laws and regulations, and reliability of performance reporting.

Assurance Statement

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

Jeffrey Jarrett, Director

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

For 2004, we conducted assessments of selected programs and administrative functions that were sufficient to ensure the adequacy of controls in place. Areas for improvement were identified and corrective actions are being implemented. In general, we found our management controls adequate to safeguard our programs and systems against waste, fraud, abuse, and mismanagement. No material weaknesses were identified (see Figure 10).

Figure 10
2004 Management Control Reviews

Review	Scope	Results
Acquisition Management	To determine whether emergency, non-emergency, bond forfeiture and civil penalty reclamation construction contracts are properly documented and closed out by the contracting staff in Appalachian Regional Coordinating Center (ARCC) and the adequacy of existing policies and procedures for documenting and closing out construction contracts.	Minor improvements were recommended. No material weaknesses were found.
Cash Management/Debt Collection Financial Instruments	To determine if management controls on the cash management and debt collection process provided reasonable assurance that program activities were being effectively and efficiently managed.	No material weaknesses were found.
Personnel Management	To determine if the Delegated Examining within OSM is providing customers a product that meets the requirement of the law for accuracy and an effective, efficient recruitment tool.	No material weaknesses were found.
Safety Management	To determine if OSM's accident and illness reporting is done in a timely manner and has adequate management involvement.	Minor improvements were recommended. No material weaknesses were found.
Sensitive Automated Information Systems	To certify that all prescribed controls or alternative controls are in place and effective for OSM's general support systems and major applications.	No material weaknesses were found.
Travel	Review of travel vouchers to make sure that the centrally billed transactions are not being claimed as a reimbursable expense.	Minor improvements were recommended. No material weaknesses were found.
Fee Compliance Program	To determine if management controls on the reclamation fee account management process surrounding the addition of new accounts, management of current account status and the closing of accounts provide reasonable assurance that these program activities were being effectively and efficiently managed.	No material weaknesses were found.
Applicant/Violator System (AVS) Program	To determine if management controls with the AVS program provide reasonable assurance that assignment of AVS login accounts are being effectively and efficiently managed.	No material weaknesses were found.
Watershed Cooperative Agreement Program	A comprehensive look at all event cycles for the program that were active, beginning in Fiscal Year 2002 through the present day. In addition, all instructions, requirements, and website information was reviewed to determine if changes or clarifications were needed or could be made to improve the effectiveness of the program.	Minor improvements were recommended. No material weaknesses were found.

Federal Financial Management Improvement Act (FFMIA)
This law requires agencies to report on their substantial compliance with federal financial management systems requirements, federal accounting standards, and the U.S. Government Standard General Ledger. It also requires agencies to provide full disclosure of financial data, which is accomplished through the financial statements included in this report. OSM concludes that it is in substantial compliance with FFMIA.

OSM received an unqualified opinion on the financial statements, no material weaknesses in the report on internal controls and no identified significant instances of non-compliance with laws and regulations including FFMIA that could have a direct and material effect on the determination of financial statement amounts.

Other Key Legal and Financial Regulatory Requirements

Improper Payments Information Act (IPIA) of 2002
Narrative Summary of Implementation Efforts for FY 2004 and Agency Plans for FY 2005-2007
OSM is in substantial compliance with the Improper Payments Information Act (IPIA) by following the FY 2004 implementation plan.

OSM took the following steps to ensure compliance with the plan:

—Reviewed all programs we administer
—Conducted a review to determine whether any programs were susceptible to significant erroneous payments
—Estimated the amount of potential erroneous payments in the programs (less than $2,000 in total)
—Implemented a plan to reduce the potential erroneous payments
—Reported on the estimates and progress annually, beginning with the FY 2004 Performance and Accountability Report

OSM performed its review of all programs, by conducting the required Risk Assessment Rating. We also participated in the Departmental Function Reviews (DFR) of various payment processes. It was determined that OSM did not identify any programs as "High Risk" during this assessment. Also, in compliance with the IPIA initiatives, OSM prepared an action plan based on the findings from the risk assessments, to further mitigate potential erroneous or improper payments.

OSM is currently in the process of working with an independent contractor to review all vendor payments to see if recovery of payments may be appropriate.

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

- Credit cards were used to cut through red tape and expedite payment. Almost 91 percent of purchase transactions were made with credit cards in FY 2004, and the agency continues to promote their increased use, and
- Electronic funds transfer (EFT) was used to make 99.95 percent of the agency's vendor payments covering 100 percent of the dollar amount paid.

Debt Collection Improvement Act
OSM collected over 99.86 percent of the Abandoned Mine Land (AML) Reclamation Fees due this year, for a total of $286 million. This is the result of an integrated fee compliance program that works with the coal mining industry to provide clear guidance on fee payment and reporting issues, as well as active follow-up through audits and several other compliance activities. The current uncollected outstanding accounts receivable balance as of September 30, 2004, is $1.6 million, comprised of $1.2 million in AML Fees and Audit debt, and $0.4 million in civil penalties. The $1.6 million balance includes accounts that may not be collectible. After deducting for uncollectible receivables, we estimate that $0.8 million should be collectible.

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

Civil Monetary Penalty Act
To comply with the Civil Monetary Penalty Act, OSM has increased the assessment amounts of civil monetary penalties. The agency issues these penalties for violation of the Surface Mining Control and Reclamation Act.

DISCUSSION AND ANALYSIS OF THE FINANCIAL STATEMENTS

Objectives of Financial Reporting

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

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

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

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

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

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

Limitations of the Financial Statements

The financial statements have been prepared pursuant to the requirements of the Chief Financial Officers Act of 1990. While the statements have been prepared from OSM's books and records in accordance with the guidance provided by the Office of Management and Budget, the financial 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 they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without enactment of an appropriation that provides the resources and the legal authority to do so.

Significant Financial Statement Issues

Changes to the Statement of Net Cost

The Government Performance and Results Act (GPRA) requires that Federal agencies formulate strategic plans, identify major strategic goals, and report performance measures and costs related to these goals. In order to correlate with changes made by DOI in its Strategic Plan for 2004, OSM revised its GPRA Goals to align with those of the Department. Accordingly, OSM presented its earned revenues and gross costs for FY 2004 by the Mission Areas in the Department's FY 2004 Strategic Plan and its earned revenues and gross costs for FY 2003 by the GPRA Goals in the FY 2001 Strategic Plan. As a result, the FY 2004 Consolidated Statement of Net Cost cannot be compared directly to the FY 2003 Consolidated Statement of Net Cost. OSM's former Environmental Restoration responsibility segment is subdivided into Resource Protection and Serving Communities; the former Environmental Protection segment is now titled Resource Use.

Difference in the UMWA-CBF Payment and Receivable

OSM's transfer of money to the UMWA-CBF fluctuates annually based on OSM's projected interest earnings, the projected needs of the fund, and a reconciliation of actual prior year expenses of the fund, which can result in a receivable or a payable. In FY 2003, OSM paid $90 million to the UMWA-CBF; in FY2004, the cash payment was $15 million, a difference of $75 million. The effect of this difference is evident on the Statement of Budgetary Resources: Appropriations Received (the UMWA-CBF payment is appropriated annually) is $73 million less for 2004; Obligations Incurred and Disbursements are similarly impacted. There were refunds receivable from the UMWA-CBF recorded in both FY 2004 and FY 2003, for $7 million and $33.7 respectively. This explains the $26 million difference in Accounts and Interest Receivable on the Balance Sheet.

AML Fee Reauthorization

OSM is authorized to collect fees through the Surface Mining Control and Reclamation Act (SMCRA). This authorization expired on September 30, 2004. On September 29, 2004, the Office of Surface Mining (OSM) received an extension of its fee collections authority to fund the reclamation of abandoned mine lands through November 20, 2004. We received this extension under a continuing resolution. Should there be additional continuing resolutions, the OSM fee collection authority will be extended concurrently. If Congress does not renew the OSM's authority beyond the continuing resolutions, OSM will have sufficient funds to continue, and plans to continue, its current abandoned mine lands programs at their current operating levels through September 30, 2005. Further, OSM will have sufficient funding to continue as a going concern through September 30, 2005.

Department of the Interior
Office of Surface Mining
Consolidated Balance Sheets

As of September 30, 2004 and September 30, 2003
(dollars in thousands)

	2004	2003
ASSETS (Note 2)		
Intragovernmental Assets		
Fund Balance with Treasury (Note 3)	$44,792	$42,763
Investments, Net (Notes 4 and 19)	2,051,300	1,926,867
Accounts and Interest Receivable (Note 5)	45	30
Other		
Advances and Prepayments	50	161
Total Intragovernmental Assets	**2,096,187**	**1,969,821**
Accounts and Interest Receivable, Net (Note 6)	6,631	35,010
General Property, Plant & Equipment, Net (Note 7)	2,561	2,978
TOTAL ASSETS	**$2,105,379**	**$2,007,809**
LIABILITIES (Note 8)		
Intragovernmental Liabilities		
Accounts Payable	$45	$259
Other		
Accrued Payroll and Benefits	1,020	1,137
Advances and Deferred Revenue	4	-
Deposit Fund Liability	2	152
Other Liabilities (Note 9)	480	562
Total Intragovernmental Liabilities	**1,551**	**2,110**
Public Liabilities		
Accounts Payable	17,947	12,054
Federal Employees Compensation Act Liability	3,829	4,440
Other		
Accrued Payroll and Benefits	6,249	5,534
Deposit Fund Liability	834	575
Contingent Liabilities (Note 10)	68,600	68,500
Total Public Liabilities	**97,459**	**91,103**
TOTAL LIABILITIES	**99,010**	**93,213**
Commitments and Contingencies (Note 11)		
NET POSITION		
Unexpended Appropriations	38,490	36,299
Cumulative Results of Operations	1,967,879	1,878,297
TOTAL NET POSITION	**2,006,369**	**1,914,596**
TOTAL LIABILITIES AND NET POSITION	**$2,105,379**	**$2,007,809**

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

Department of the Interior
Office of Surface Mining
Consolidated Statement of Net Cost

For the year ended September 30, 2004
(dollars in thousands)

	2004
Resource Use - manage resource use to enhance public benefit	
Cost of Services Provided to the Public	$105,844
Less: Revenue Earned from the Public	105
Net Cost of Services to the Public	105,739
Cost of Services Provided to Federal Agencies	1,193
Less: Revenue Earned from Federal Agencies	1,119
Net Cost of Services to Federal Agencies	74
Net Cost of Operations	**105,813**
Serving Communities - protect lives, resources and property	
Cost of Services Provided to the Public	137,372
Less: Revenue Earned from the Public	4
Net Cost of Services to the Public	137,368
Cost of Services Provided to Federal Agencies	23
Less: Revenue Earned from Federal Agencies	22
Net Cost of Services to Federal Agencies	1
Net Cost of Operations	**137,369**
Resource Protection - improve health of watersheds and landscapes	
Cost of Services Provided to the Public	72,131
Less: Revenue Earned from the Public	-
Net Cost of Services to the Public	72,131
Cost of Services Provided to Federal Agencies	-
Less: Revenue Earned from Federal Agencies	-
Net Cost of Services to Federal Agencies	-
Net Cost of Operations	**72,131**
UMWA-CBF Transfer	
Cost of Services Provided to the Public	42,696
Less: Revenue Earned from the Public	-
Net Cost of Services to the Public	42,696
Cost of Services Provided to Federal Agencies	-
Less: Revenue Earned from Federal Agencies	-
Net Cost of Services to Federal Agencies	-
Net Cost of Operations	**42,696**
Total	
Cost of Services Provided to the Public	358,043
Less: Revenue Earned from the Public	109
Net Cost of Services to the Public	357,934
Cost of Services Provided to Federal Agencies	1,216
Less: Revenue Earned from Federal Agencies	1,141
Net Cost of Services to Federal Agencies	75
Total Net Cost of Operations (Note 12)	**$358,009**

The accompanying notes are an integral part of these financial statements

Department of the Interior
Office of Surface Mining
Consolidated Statement of Net Cost

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

	2003
Environmental Restoration	
Cost of Services Provided to the Public	$191,257
Less: Revenue Earned from the Public	86
Net Cost of Services to the Public	191,171
Cost of Services Provided to Federal Agencies	97
Less: Revenue Earned from Federal Agencies	96
Net Cost of Services to Federal Agencies	1
Net Cost of Operations	**191,172**
Environmental Protection	
Cost of Services Provided to the Public	153,467
Less: Revenue Earned from the Public	117
Net Cost of Services to the Public	153,350
Cost of Services Provided to Federal Agencies	987
Less: Revenue Earned from Federal Agencies	967
Net Cost of Services to Federal Agencies	20
Net Cost of Operations	**153,370**
UMWA-CBF Transfer	
Cost of Services Provided to the Public	48,249
Less: Revenue Earned from the Public	-
Net Cost of Services to the Public	48,249
Cost of Services Provided to Federal Agencies	-
Less: Revenue Earned from Federal Agencies	-
Net Cost of Services to Federal Agencies	-
Net Cost of Operations	**48,249**
Total	
Cost of Services Provided to the Public	392,973
Less: Revenue Earned from the Public	203
Net Cost of Services to the Public	392,770
Cost of Services Provided to Federal Agencies	1,084
Less: Revenue Earned from Federal Agencies	1,063
Net Cost of Services to Federal Agencies	21
Total Net Cost of Operations (Note 12)	**$392,791**

The accompanying notes are an integral part of these financial statements

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

For the years ended September 30, 2004 and September 30, 2003
(dollars in thousands)

	2004	2003
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$36,299	$36,038
Budgetary Financing Sources		
Appropriations Received, General Funds	106,424	105,092
Appropriations-Used	(101,939)	(103,609)
Other Adjustments (rescissions, etc.)	(2,294)	(1,222)
Total Budgetary Financing Sources	**2,191**	**261**
ENDING BALANCE - UNEXPENDED APPROPRIATIONS	**$38,490**	**$36,299**
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	$1,878,297	$1,856,818
Budgetary Financing Sources		
Appropriations-Used	101,939	103,609
Transfers In/Out without Reimbursement	-	(271)
Non-Exchange Revenue:		
Abandoned Mine Land Fees (Note 19)	286,160	282,411
Forfeitures of Cash	31	112
Other Non-Exchange Revenue	54,738	23,712
Other Financing Sources		
Imputed Financing from Costs Absorbed by Others	5,124	4,784
Transfers In/Out without Reimbursement	(401)	(87)
Total Financing Sources	**447,591**	**414,270**
Net Cost of Operations	**(358,009)**	**(392,791)**
ENDING BALANCE - CUMULATIVE RESULTS OF OPERATIONS	**$1,967,879**	**$1,878,297**

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

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

For the years ended September 30, 2004 and September 30, 2003
(dollars in thousands)

	2004	2003
Budgetary Resources		
Budget Authority		
Appropriations Received (Note 13)	$314,435	$387,031
Unobligated Balance		
Beginning of Fiscal Year	43,463	53,524
Spending Authority From Offsetting Collections:		
Earned		
Collected	1,196	1,173
Receivable From Federal Sources	(8)	36
Change in Unfilled Customer Orders Without Advance From Federal Sources	(97)	9
Subtotal: Spending Authority From Offsetting Collections	1,091	1,218
Recoveries of Prior Year Obligations	48,126	26,937
Temporarily Not Available Pursuant to Public Law	(2,379)	(1,468)
Permanently Not Available	(2,294)	(1,222)
Total Budgetary Resources	**$402,442**	**$466,020**
Status of Budgetary Resources		
Obligations Incurred (Note 14)		
Direct	$365,048	$421,557
Reimbursable	1,196	1,000
Total Obligations Incurred	366,244	422,557
Unobligated Balance		
Apportioned	31,942	39,372
Unobligated Balance not Available	4,256	4,091
Total Status of Budgetary Resources	**$402,442**	**$466,020**
Relationship of Obligations to Outlays		
Obligations Incurred (Note 14)	$366,244	$422,557
Obligated Balance, Net, Beginning of Fiscal Year	365,202	353,962
Obligated Balance, Net, End of Fiscal Year		
Accounts Receivable	45	53
Unfilled Customer Orders From Federal Sources	166	263
Undelivered Orders	(343,068)	(351,793)
Accounts Payable	(19,815)	(13,725)
Less: Spending Authority Adjustments	(48,021)	(26,982)
Outlays		
Disbursements	320,753	384,335
Collections	(1,196)	(1,173)
Subtotal	319,557	383,162
Less: Offsetting Receipts (Note 15)	(46,603)	(23,842)
Net Outlays	**$272,954**	**$359,320**

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

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

For the years ended September 30, 2004 and September 30, 2003
(dollars in thousands)

	2004	2003
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 14)	$366,244	$422,557
Less: Spending Authority From Offsetting Collections/Adjustments	(49,217)	(28,155)
Obligations Net of Offsetting Collections and Adjustments	317,027	394,402
Less: Offsetting Receipts (Note 15)	(46,603)	(23,842)
Net Obligations	270,424	370,560
Other Resources:		
Transfers In/Out Without Reimbursement	(401)	(87)
Imputed Financing From Costs Absorbed by Others	5,124	4,784
Net Other Resources Used to Finance Activities	4,723	4,697
Total Resources Used to Finance Activities	275,147	375,257
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	8,739	(9,212)
Resources That Fund Expenses Recognized in Prior Periods	(80)	(7,343)
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations		
Offsetting Receipts Not Part of the Net Cost of Operations	46,608	23,849
Resources That Finance the Acquisition of Assets	(209)	(885)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	55,058	6,409
Total Resources Used to Finance the Net Cost of Operations	**330,205**	**381,666**
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	205	34
Other		
Change in Legal Liabilities	100	43,451
Change in UMWA-CBF Receivable	27,729	(33,700)
Other	(629)	1,004
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	27,405	10,789
Components Not Requiring or Generating Resources		
Depreciation and Amortization	626	590
Allocation Transfer Account Reconciling Item (Note 17)	(228)	(254)
Bad Debt Expense	1	-
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	399	336
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**27,804**	**11,125**
Net Cost of Operations	**$358,009**	**$392,791**

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

Office of Surface Mining
Notes to Financial Statements
For the Years Ended September 30, 2004 and 2003

Note 1. Summary of Significant Accounting Policies:

A. Reporting Entity

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

On September 29, 2004, Congress adopted a continuing resolution to fund a number of federal agencies which included the U.S. Department of the Interior. The continuing resolution included language to extend the Office of Surface Mining's authority to collect fees from coal companies to pay for the abandoned Mine Land program until November 20, 2004. This continuing resolution funds the operation of the U.S. Department of the Interior until that time, which is when Congress is expected to review and approve funding for DOI for the remainder of FY 2005.

In the absence of the fee reauthorization by Congress, Section 402(b) of SMCRA requires OSM to establish a new fee at a rate schedule sufficient to continue to provide for the needs of certain beneficiaries of the United Mine Workers Combined Benefit Fund (UMWA-CBF). OSM provides an annual transfer to the UMWA-CBF to help defray the health care costs of mine workers and their beneficiaries for which no current mining company is responsible. SMCRA allows an annual transfer of up to $70 million to fulfill this requirement. To establish a new fee rate schedule OSM issued a final Rule in September 2004 that will provide $69 million for the UMWA-CBF in FY 2005. The new fee rates will not take legal effect until the current continuing resolution expires on November 20, 2004, or upon the expiration of any subsequent continuing resolution that extends the coal reclamation fee collection authority. Similarly, the new fee rates will not be needed if Congress reauthorizes or otherwise extends the expiration date of the current program.

If Congress does not renew the OSM's authority beyond November 20, 2004, OSM's management believes that OSM will have sufficient funds to continue, and plans to continue, its current Abondoned Mine Lands (AML) program at the current operating level through September 30, 2005. Further, OSM's management believes that the OSM will have sufficient funds to continue as a going concern through September 30, 2005.

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

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

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

1. General Funds: These funds consist of expenditure accounts used to record financial transactions arising from congressional appropriations as well as receipt accounts. The principal general fund expenditure and receipt accounts maintained are:

    a. Regulation and Technology - These funds consist of expenditure accounts used to record financial transactions arising from congressional appropriations to spend general revenue. These funds support the financing of state regulatory grants, oversight of state regulatory programs, research and development facilitating the transfer of reclamation expertise to states, and the partial financing of all OSM operations and maintenance costs. Funding is appropriated on an annual basis.
    b. Bond Forfeitures – This fund consists of receipt and expenditure accounts. Monies collected on bonds forfeited by coal operators are used to reclaim the mine sites secured by the bonds.

2. Special Funds: These funds consist of special fund receipt, expenditure, and investment accounts and include the following:

   a. Abandoned Mine Land (AML) Funds - These funds were established by SMCRA for the deposit of coal reclamation fees, related late payment interest, and administrative charges recovered in pursuing collections. Available reclamation fees are used solely to finance the AML reclamation program. However, before AML funds can be used, a Congressional appropriation is necessary to authorize yearly spending limits. Available AML special fund balances, in excess of current cash requirements, are regularly invested in non-marketable federal securities as authorized under Public Law 101-508.
   b. Civil Penalties - This fund consists of receipt and expenditure accounts used to collect penalties levied against operators who violate any permit condition or provision of Title 30 U.S.C. 1268. Funds from these assessments are used to reclaim lands adversely affected by coal mining practices on or after August 3, 1977.

3. Deposit Funds: These funds are maintained to account for receipts awaiting proper classification or receipts held in escrow until ownership is established, at which time proper distribution can be made. Additionally, OSM collects miscellaneous interest, judicial service and administrative fees which are credited to Treasury's general fund. In the billing and collection of these funds, OSM is merely acting as an agent for the Treasury.

Government Performance and Results Act (GPRA) Performance Goals – GPRA requires that Federal agencies formulate strategic plans, identify major strategic goals, and report performance and costs related to these goals. Because the Department of the Interior updated its strategic plan and mission goals in FY2004, OSM changed its GPRA reporting to align with that of the Department. As of this year, OSM's former Environmental Restoration responsibility segment is subdivided into Resource Protection and Serving Communities; the former Environmental Protection segment is now titled Resource Use. OSM's 2004 GPRA responsibility segments are:

1. Resource Use: This program is responsible for ensuring that the SMCRA's goals are achieved, primarily through the States and Indian Tribes. It includes OSM rule making, grants to States and Indian Tribes to conduct and develop their regulatory programs, OSM regulatory operations in non-primacy states, OSM state program evaluations and oversight, and OSM regulatory technology development and transfer.
2. Resource Protection: This is a component of the OSM reclamation program which is responsible for the reclamation of abandoned mine lands affected by mining that took place before SMCRA was passed in 1977. The resource protection activities are primarily conducted through grants given to states and tribes; and by environmental restoration technical assistance, training, and technology development provided to states and tribes. The financial management of AML fees and investments, and bond forfeiture and civil penalty reclamations projects are included in this goal.
3. Serving Communities: This reclamation activity protects the lives and property of citizens living in proximity to coal fields, again primarily through grants to states and tribes. It also includes federal reclamation work in emergency situations and the AML state oversight and grants administration activities.
4. United Mine Workers of America Combined Benefit Fund Transfer (UMWA-CBF): This program is for the transfer of funds to the United Mine Workers of America Combined Benefit Fund. This is an annual transfer required by the Energy Policy Act of 1992. The transfer is used to pay for health care benefits for certain coal miners and their beneficiaries.

B. Basis of Accounting and Presentation

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

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

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

Office of Surface Mining
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For the Years Ended September 30, 2004 and 2003 (continued)

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

1. FASAB Statements entitled Statements of Federal Financial Accounting Standards (SFFAS). These statements reflect the accounting principles, standards, and requirements recommended by the FASAB and approved by the General Accountability Office (GAO), OMB and Treasury. Additionally, FASAB interpretations provide further clarification to the approved standards.

2. Form and content requirements for financial statements, as presented in OMB Bulletin No. 01-09 (Form and Content of Agency Financial Statements). Note that the provisions of published SFFAS and interpretations take precedence over OMB Form and Content guidance.

3. Other Authoritative Guidance. If questions arise regarding issues that are not addressed by SFFAS or OMB Form and Content guidance, the agency looks to authoritative guidance issued by other standard setting bodies, such as the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

4. The accounting principles and standards contained in departmental and bureau accounting policy and procedures manuals, and/or related guidance.

5. Statements of Federal Financial Accounting Concepts (SFFAC). These concepts are not authoritative, per se, and do not have required implementation dates. However, they do contain very useful guidance regarding the completeness of the reporting entity and the presentation of financial information.

C. Revenues and Financing Sources

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

The AML program is funded by a reclamation fee assessed on coal mine operators. The fee is based on the type and volume of coal produced for sale, transfer, or use. As appropriated by Congress, monies received and deposited in this special fund are used to reclaim lands adversely affected by past mining. Fees collected, but not yet appropriated, are held for future appropriations. Payments to the UMWA-CBF are funded through earnings on investments of undisbursed AML fund balances. See Notes 1.G and 4 for additional information.

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

D. Distribution of AML Appropriation for Reclamation Grants

OSM distributes the Congressional appropriation from the collections of AML fees through grants to states and tribes. The distribution contains three main components: state-share distribution, federal- share distribution, and emergency program distribution. The state-share portion is based on the percentage of each state's balance in the AML Special Fund. All states or tribes with a participating state or tribal reclamation program receive state-share distributions on an annual basis if they have a balance in the fund. OSM distributes additional monies from the federal-share portion of the AML appropriation based upon state historical coal production prior to 1978. Under the minimum program provision, OSM distributes at least $1.5 million to states or tribes with qualifying reclamation projects. This provides additional funding for Priority 1 and Priority 2 AML coal projects. Priority 1 projects protect public health, safety, general welfare, and property from extreme danger of adverse effects of mining practices or conditions that could reasonably be expected to cause substantial physical harm to persons or property, and to which persons or improvements on real property are currently exposed. Priority 2 projects protect public health, safety and general welfare from adverse effects of mining practices or a condition that is threatening people, but is not an extreme danger. OSM also distributes monies to be used only for qualifying emergency programs from the federal-share portion of the appropriation.

E. Grant Expenditures

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

F. Fund Balance with Treasury

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

G. Investments

OSM invests excess cash from AML fee collections in Treasury notes and certificates. Note 4 provides additional information concerning investments. Some of the earnings from these investments are transferred to the UMWA-CBF.

H. Allowance for Doubtful Accounts

OSM's allowance methodology is representative of the collectability of delinquent accounts. OSM uses two different methodologies to recognize bad debts arising from uncollectible accounts receivable, the net of the allowance method and the specific analysis method. The net of the allowance method is used for special and civil penalty funds accounts receivable. Under this method, an allowance for doubtful accounts is calculated based upon OSM's past experience in successfully collecting delinquent accounts receivable by aging category. However, the specific analysis method may be used, as it was in 2003, if any one account is a substantial percent of the outstanding accounts receivable. For all other types of receivables, the allowance is based on an analysis of each account receivable.

I. Personnel Compensation and Benefits

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

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

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

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

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

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

J. Income Taxes

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

K. Use of Estimates

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

Office of Surface Mining
Notes to Financial Statements
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Note 2. Asset Analysis:

Assets can be classified as entity or non-entity and restricted or unrestricted. Entity assets are those that OSM has the authority to use in its operations. Non-entity assets include certain accounts and interest receivable that will be forwarded to the Treasury upon collection. OSM's non-entity assets were less than one thousand dollars for fiscal years 2003 and 2004. In general, large trust funds that are outside the scope of bureau day-to-day operations are further classified by the DOI as restricted. OSM does not hold any restricted assets.

(dollars in thousands)	Unrestricted Entity 2004	Unrestricted Entity 2003
Assets		
Intragovernmental Assets		
Fund Balance with Treasury	$44,792	$42,763
Investments, Net	2,051,300	1,926,867
Accounts and Interest Receivable, Net	45	30
Other		
Advances and Prepayments	50	161
Total Intragovernmental Assets	**2,096,187**	**1,969,821**
Accounts and Interest Receivable, Net	6,631	35,010
General Property, Plant & Equipment, Net	2,561	2,978
Total Assets	**$2,105,379**	**$2,007,809**

Note 3. Fund Balance with Treasury:

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

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

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

Fund Balances by Fund Type

(dollars in thousands)	2004	2003
General Funds	$43,075	$41,213
Special Funds	877	823
Other Fund Types	840	727
Total Fund Balance with Treasury by Fund Type	**$44,792**	**$42,763**

Status of Fund Balance with Treasury

(dollars in thousands)	2004	2003
Unobligated		
Available	$1,651	$1,789
Unavailable	5,095	4,818
Obligated Not Yet Disbursed	38,046	36,156
Total Status of Fund Balance with Treasury	**$44,792**	**$42,763**

In addition to the amounts disclosed above, $983 thousand was returned to Treasury at the end of FY 2004 for a cancelled annual year fund.

Note 4. Net Investments, Non-Marketable:

Effective October 1, 1991, OSM was given authority to invest the balance of the AML Fund in non-marketable federal securities under Public Law 101-508. The Bureau of Public Debt is the sole issuer of authorized non-marketable Federal securities, which are purchased by OSM directly from the Treasury. OSM may invest in bills, notes, bonds, and one-day certificates. There are no restrictions on federal agencies as to the use or convertibility of Treasury non-marketable securities. In 2003 OSM was invested in one-day certificates. The investment strategy changed in 2004, and OSM is now invested in one-day certificates and 10-year Treasury Notes. As of September 30, 2004, and September 30, 2003, OSM had $748.7 million and $1.8 billion in one-day certificates, respectively. All remaining investments as of September 30, 2004, were in 10-year Treasury Notes. OSM intends to hold the notes to maturity.

(dollars in thousands) **Security Type**	**Cost**	**Amortized Discount (Premium)**	**Investments,Net**	**Market Value Disclosure**
2004				
Non-Marketable:				
Market Based	$2,042,801	$168	$2,042,969	$2,042,969
Accrued Interest	8,331	-	8,331	8,331
Totals	**$2,051,132**	**$168**	**$2,051,300**	**$2,051,300**
2003				
Non-Marketable:				
Market Based	$1,926,867	$-	$1,926,867	$1,926,867
Accrued Interest	-	-	-	-
Totals	**$1,926,867**	**$-**	**$1,926,867**	**$1,926,867**

Note 5. Intragovernmental Accounts Receivable:

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

(dollars in thousands)	**2004**	**2003**
Unbilled Intragovernmental Accounts Receivable	**$45**	**$30**

Note 6. Accounts and Interest Receivable, Net:

Accounts receivable with the public are recorded net of the allowance for doubtful accounts. These receivables represent uncollected Abandoned Mine Land, civil penalty and audit fees, including related interest receivables. Additionally, OSM accrued accounts receivable from the United Mine Worker's Combined Benefit Fund in the amount of $6 million in FY 2004 and $33.7 million in FY 2003. This receivable, the result of over-estimating beneficiaries' needs and OSM's future interest earnings, will offset OSM's annual payment to the UMWA-CBF.

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

(dollars in thousands)	**2004**	**2003**
Accounts Receivable from the Public		
Current	$405	$1,564
1 - 180 Days Past Due	185	387
181 - 365 Days Past Due	289	611
Over 1 Year Past Due	736	460
Total Billed Accounts Receivable - Public	1,615	3,022
Unbilled Accounts Receivable	5,971	33,723
Total Accounts Receivable - Public	7,586	36,745
Allowance for Doubtful Accounts	(955)	(1,735)
Total Accounts Receivable - Public, Net	**$6,631**	**$35,010**
Change in Allowance for Doubtful Accounts		
Allowance for Doubtful Accounts, beginning	$1,735	$1,802
Additions	212	1,558
Deletions	(992)	(1,625)
Allowance for Doubtful Accounts	**$955**	**$1,735**

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

OSM does not own any real estate or buildings; however, OSM capitalizes tenant improvements to office space as leasehold improvements. Leasehold improvements are capitalized when the acquisition cost is $100 thousand or more. They are depreciated using the straight-line method over the useful life according to GSA schedules.

Personal property and equipment are valued at historical cost and are capitalized whenever the initial acquisition cost is $15 thousand or greater and the estimated useful life is two years or longer. Property and equipment are depreciated using the straight-line method and an asset's useful life is determined using OMB guidance.

2004

(dollars in thousands)	Service Life in Years	Acquisition Value	Accumulated Depreciation	Net Book Value
Equipment				
Automated Data Processing	15	$1,331	($831)	$500
Office	11-20	963	(333)	630
Vehicles	6-10	2,916	(1,946)	970
Leasehold Improvements	2-10	599	(138)	461
Totals		**$5,809**	**($3,248)**	**$2,561**

2003

(dollars in thousands)	Service Life in Years	Acquisition Value	Accumulated Depreciation	Net Book Value
Equipment				
Automated Data Processing	15	$1,520	($1,031)	$489
Office	11-20	924	(277)	647
Vehicles	6-10	2,993	(1,702)	1,291
Leasehold Improvements	2-10	599	(48)	551
Totals		**$6,036**	**($3,058)**	**$2,978**

Note 8. Liabilities:

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

2004

	Covered by Budgetary Resources		Not Covered by Budgetary Resources		
(dollars in thousands)	**Current**	**Non-Current**	**Current**	**Non-Current**	**Total**
Intragovernmental Liabilities					
Accounts Payable	$45	$-	$-	$-	$45
Other					
Accrued Payroll and Benefits	290	-	287	443	1,020
Advances and Deferred Revenue	4	-	-	-	4
Deposit Fund Liabilities	2	-	-	-	2
Other Liabilities	-	-	69	411	480
Total Intragovernmental Liabilities	**341**	**-**	**356**	**854**	**1,551**
Public Liabilities					
Accounts Payable	17,947	-	-	-	17,947
Federal Employees Compensation Act Liability	-	-	-	3,829	3,829
Other					
Accrued Payroll and Benefits	1,532	-	-	4,717	6,249
Deposit Fund Liabilities	-	-	172	662	834
Contingent Liabilities	-	-	50	68,550	68,600
Total Public Liabilities	**19,479**	**-**	**222**	**77,758**	**97,459**
Total Liabilities	**$19,820**	**$-**	**$578**	**$78,612**	**$99,010**

2003

	Covered by Budgetary Resources		Not Covered by Budgetary Resources		
(dollars in thousands)	**Current**	**Non-Current**	**Current**	**Non-Current**	**Total**
Intragovernmental Liabilities					
Accounts Payable	$259	$-	$-	$-	$259
Other					
Accrued Payroll and Benefits	218	-	300	619	1,137
Deposit Fund Liabilities	152	-	-	-	152
Other Liabilities	-	-	83	479	562
Total Intragovernmental Liabilities	**629**	**-**	**383**	**1,098**	**2,110**
Public Liabilities					
Accounts Payable	12,054	-	-	-	12,054
Federal Employees Compensation Act Liability	-	-	-	4,440	4,440
Other					
Accrued Payroll and Benefits	1,194	-	-	4,340	5,534
Deposit Fund Liabilities	-	-	575	-	575
Contingent Liabilities	-	-	-	68,500	68,500
Total Public Liabilities	**13,248**	**-**	**575**	**77,280**	**91,103**
Total Liabilities	**$13,877**	**$-**	**$958**	**$78,378**	**$93,213**

Note 9. Other Liabilities:

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

The majority ($479 thousand) of OSM's other liabilities represent amounts owed to the General Services Administration (GSA) for tenant improvements provided to OSM for leased office spaces.

Office of Surface Mining
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Note 10. Contingent and Environmental Liabilities:

1. Contingent Legal Liabilities: There have been claims filed against OSM with adjudications pending. As of September 30, 2004 a liability of $68.6 million has been accrued in the financial statements for cases in which payment has been deemed probable and for which the amount of potential liability is estimable. The U.S. Treasury's Judgment Fund would likely bear most of the costs incurred to pay any judgments or settlements and the resultant outcomes should not materially affect OSM's future financial condition. The related liability at September 30, 2003 was $68.5 million.

   Federal accounting guidance states that if an estimated liability is a range of amounts, and no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized. The amounts recognized above are the minimum amounts in the range noted for these liabilities. The upper limits on the ranges of these liabilities are $78.8 million for FY2004 and $78.5 million for FY 2003.

   In addition to the amounts recorded above, OSM has adjudications pending where the likelihood of an unfavorable outcome is reasonably possible. An estimate of potential loss for pending adjudications in this category for FY 2004 ranges from $237 thousand to $700 thousand; the FY 2003 possible loss was $100 thousand. However, no amounts have been accrued in the financial records for claims where the probability or amount of judgment is uncertain.

2. Environmental Liabilities: The Congress has identified the reclamation of abandoned mine sites as an objective of providing for the general health and safety of the people. In order to finance the reclamation, OSM collects a fee for coal sold or used from current mining operations into a fund called the Abandoned Mine Land Fund. The purpose of this fee is to support, among other things, the reclamation of abandoned mine lands. Congress authorizes the funding for these projects on an annual basis through appropriations from this fund.

   Although OSM's mission includes the administration of programs designed to protect society from the effects of coal mining operations, OSM has no liability for future environmental cleanup. OSM does not own land or contribute to environmental contamination. However, OSM provides some funding, through grants for states and tribes and through contracting in states or tribal lands that do not have approved abandoned mine land programs, in order to reclaim eligible abandoned mine sites or to work on other qualified projects. All costs associated with these projects are accrued in the accompanying financial statements.

Note 11. Commitments and Contingencies:

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

Note 12. Net Cost by Segment:

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, requires agencies to report the full cost of programs, activities, and outputs. This standard includes requirements for accumulating and reporting costs on a regular basis for management use, establishing responsibility segments to match costs with outputs, determining the full cost of government goods and services, recognizing the costs of services provided between agencies within the government, and using appropriate costing methodologies to accumulate and assign costs to outputs. The accumulated cost data is aggregated by program activity to reflect the Government Performance and Results Act (GPRA) performance goals.

GPRA requires that Federal agencies formulate Strategic Plans, identify major strategic goals, and report performance measures and costs related to these goals. Under GPRA, Departments' Strategic Plans are to be revised and updated every three years. In order to correlate with changes made by DOI for 2004, OSM revised its GPRA Goals to align with those of the Department.

GPRA also requires that Federal agencies report costs for the goals identified in the Strategic Plan. Accordingly, OSM presented its earned revenues and gross costs for FY 2004 by the Mission Areas in the Department's FY 2004 Strategic Plan and its earned revenues and gross costs for FY 2003 by the GPRA Goals in the FY 2001 Strategic Plan. As a result, the FY 2004 Consolidated Statement of Net Cost cannot be compared directly to the FY 2003 Consolidated Statement of Net Cost.

OSM's net cost is presented below by responsibility segment and program activity with intragovernmental and public disclosures. The Operations segment accounts for those net costs required to operate OSM and its Federal programs that are not transferred to states and tribes in the form of grants. Intragovernmental gross costs approximate intragovernmental revenues with the addition of a pro rata share of imputed costs.

2004 Consolidating Schedule by Responsibility Segment

(dollars in thousands)	Office of Surface Mining Operations	Grants to Statesand Tribes	Authorized Special Payments	2004 Total
Resource Use				
Cost of Services Provided to the Public	$48,815	$57,029	$-	$105,844
Less: Revenue Earned from the Public	105	-	-	105
Net Cost of Services to the Public	48,710	57,029	-	105,739
Cost of Services Provided to Federal Agencies	1,193	-	-	1,193
Less: Revenue Earned from Federal Agencies	1,119	-	-	1,119
Net Cost of Service to Federal Agencies	74	-	-	74
Net Cost of Operations	**48,784**	**57,029**	**-**	**105,813**
Serving Communities				
Cost of Services Provided to the Public	26,674	110,698	-	$137,372
Less: Revenue Earned from the Public	4	-	-	4
Net Cost of Services to the Public	26,670	110,698	-	137,368
Cost of Services Provided to Federal Agencies	23	-	-	23
Less: Revenue Earned from Federal Agencies	22	-	-	22
Net Cost of Service to Federal Agencies	**1**	**-**	**-**	**1**
Resource Protection				
Cost of Services Provided to the Public	15,060	57,071	-	72,131
Less: Revenue Earned from the Public	-	-	-	-
Net Cost of Services to the Public	15,060	57,071	-	72,131
Cost of Services Provided to Federal Agencies	-	-	-	-
Less: Revenue Earned from Federal Agencies	-	-	-	-
Net Cost of Service to Federal Agencies	-	-	-	-
Net Cost of Operations	**15,060**	**57,071**	**-**	**72,131**
UMWA-CBF Transfer				
Cost of Services Provided to the Public	-	-	42,696	42,696
Less: Revenue Earned from the Public	-	-	-	-
Net Cost of Services to the Public	-	-	42,696	42,696
Cost of Services Provided to Federal Agencies	-	-	-	-
Less: Revenue Earned from Federal Agencies	-	-	-	-
Net Cost of Service to Federal Agencies	-	-	-	-
Net Cost of Operations	**-**	**-**	**42,696**	**42,696**
Total				
Cost of Services Provided to the Public	90,549	224,798	42,696	358,043
Less: Revenue Earned from the Public	109	-	-	109
Net Cost of Services to the Public	90,440	224,798	42,696	357,934
Cost of Services Provided to Federal Agencies	1,216	-	-	1,216
Less: Revenue Earned from Federal Agencies	1,141	-	-	1,141
Net Cost of Service to Federal Agencies	75	-	-	75
Net Cost of Operations	**$90,515**	**$224,798**	**$42,696**	**$358,009**

Office of Surface Mining
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2003 Consolidating Schedule by Responsibility Segment

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

Note 13. Appropriations Received:

1. Permanent Indefinite Appropriations: In addition to amounts annually appropriated by Congress to administer the Abandoned Mine Land Fund, SMCRA authorizes an annual transfer to the UMWA-CBF. This appropriated transfer can be classified as a permanent indefinite appropriation, i.e., the budget authority is a permanent authorization in SMCRA and is of an indefinite amount determined on an annual basis to comply with the provisions of the law.

2. Appropriations Received: The amounts in Appropriations Received on the Statement of Budgetary Resources differ from those reported on the Statement of Changes in Net Position because the latter statement excludes dedicated collections.

Note 14. Apportionment Categories of Obligations Incurred:

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

(dollars in thousands)	Apportioned Category A	Apportioned Category B	Not Subject to Apportionment	Total
2004				
Obligations Incurred				
Direct	$-	$365,048	$-	$365,048
Reimbursable	-	1,196	-	1,196
Total Obligations Incurred	**$-**	**$366,244**	**$-**	**$366,244**

2003	Apportioned Category A	Apportioned Category B	Not Subject to Apportionment	Total
Obligations Incurred				
Direct	$-	$421,557	$-	$421,557
Reimbursable	-	1,000	-	1,000
Total Obligations Incurred	**$-**	**$422,557**	**$-**	**$422,557**

Note 15. Offsetting Receipts:

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

Note 16. Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the United States Government:

For OSM, the differences between the Statement of Budgetary Resources (SBR) and the Budget of the United States Government are caused by the unique reporting requirements and objectives of those two reports. The differences do not indicate errors and are not significant.

Note 17. Allocation Transfer Account, Reconciling Item:

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

Budget authority that is transferred to another agency or bureau will create a reconciling item on the Statement of Financing because OSM reports the related budget activity on the Statement of Budgetary Resources while the Natural Resource Conservation Service reports its results of operations on its Statement of Net Cost. This presentation is required by authoritative accounting guidance. For 2004 and 2003, respectively, the reconciling amounts were $228 thousand and $254 thousand.

Office of Surface Mining
Notes to Financial Statements
For the Years Ended September 30, 2004 and 2003 (continued)

Note 18. Operating Leases:

OSM's facilities are rented from the General Services Administration (GSA), which charges rent that is intended to approximate commercial rental rates. For Federally-owned property, OSM generally enters into cancelable 10-year occupancy agreements with GSA. OSM is normally required to give 120 to 180 days notice to vacate the property and the amount of these agreements remains fairly constant from year to year. These agreements are included in the estimated future lease payments for FY 2005 through termination of the lease agreements. For non-Federally owned property, an occupancy agreement is executed, and again OSM may normally cancel these agreements with 120 days notice. The estimated rent payments to GSA for both Federally-owned and publicly-owned buildings are presented in the table that follows. OSM rental expense for 2004 and 2003 was $3,117 and $3,422 thousand, respectively. The future rent projections are based on an escalation factor of 1.7 percent for 2005 and an average escalation of 1.5 percent thereafter, in accordance with GSA budget estimates.

	Real Property		Personal Property		
(dollars in thousands)	Federal	Non-Federal	Federal	Non-Federal	Total
Fiscal Year					
2005	$2,938	$-	$6	$7	$2,951
2006	2,761	-	6	7	2,774
2007	2,799	-	6	7	2,812
2008	2,804	-	6	7	2,817
2009	2,750	-	6	-	2,756
Thereafter	13,390	-	7	-	13,397
Total Future Lease Payments	**$27,442**	**$-**	**$37**	**$28**	**$27,507**

Note 19. Dedicated Collections:

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

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

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

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

AML program expenses approximate the net cost for the Serving Communities and Resource Protection GPRA program activities with the addition (+/-) of a pro rata share of allocated costs.

The following table provides condensed information on the AML Fund:

(dollars in thousands)	2004	2003
Assets		
Fund Balance with Treasury	$583	$543
Investments, Net	2,051,300	1,926,867
Amounts Due from UMWA-CBF	5,971	33,700
Accounts Receivable, Net	607	1,265
Other – Advances and Prepayments	22	40
Total Assets	**$2,058,483**	**$1,962,415**
Liabilities		
Accounts Payable	$15,286	$9,304
Other	648	477
Total Liabilities	15,934	9,781
Total Net Position	2,042,549	1,952,634
Total Liabilities and Net Position	**$2,058,483**	**$1,962,415**

	2004	2003
Change in Net Position		
Net Position, Beginning of Fiscal Year	**$1,952,634**	**$1,886,154**
Change in Net Position		
Non-exchange Revenue		
AML Fee Revenue	286,160	282,411
Investment Interest and Other	54,652	23,720
Exchange Revenue - Services Provided and Other	26	103
Program Expenses	(235,956)	(191,505)
UMWA-CBF Expenses	(14,967)	(48,249)
Net Position, End of Fiscal Year	**$2,042,549**	**$1,952,634**

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

For the year ended September 30, 2004
(dollars in thousands)

	Abandoned Mine Lands	Regulation and Technology	Total
Budgetary Resources			
Budget Authority			
Appropriations Received	$207,936	$106,499	$314,435
Unobligated Balance			
Beginning of Fiscal Year	37,583	5,880	43,463
Spending Authority From Offsetting Collections			
Earned			
Collected	21	1,175	1,196
Receivable From Federal Sources	6	(14)	(8)
Change in Unfilled Customer Orders Without Advance From Federal Sources	(1)	(96)	(97)
Subtotal: Spending Authority From Offsetting Collections	26	1,065	1,091
Recoveries of Prior Year Obligations	46,592	1,534	48,126
Temporarily Not Available Pursuant to Public Law	(2,378)	(1)	(2,379)
Permanently Not Available	-	(2,294)	(2,294)
Total Budgetary Resources	**$289,759**	**$112,683**	**$402,442**
Status of Budgetary Resources			
Obligations Incurred			
Direct	$259,442	$105,606	$365,048
Reimbursable	26	1,170	1,196
Total Obligations Incurred	259,468	106,776	366,244
Unobligated Balance:			
Apportioned	30,291	1,651	31,942
Unobligated Balance not Available	-	4,256	4,256
Total Status of Budgetary Resources	**$289,759**	**$112,683**	**$402,442**
Relationship of Obligations to Outlays			
Obligations Incurred	$259,468	$106,776	$366,244
Obligated Balance, Net, Beginning of Fiscal Year	329,589	35,613	365,202
Obligated Balance, Net, End of Fiscal Year			
Accounts Receivable	6	39	45
Unfilled Customer Orders From Federal Sources	19	147	166
Undelivered Orders	(309,302)	(33,766)	(343,068)
Accounts Payable	(15,933)	(3,882)	(19,815)
Less: Spending Authority Adjustments	(46,597)	(1,424)	(48,021)
Outlays			
Disbursements	217,250	103,503	320,753
Collections	(21)	(1,175)	(1,196)
Subtotal	217,229	102,328	319,557
Less: Offsetting Receipts	(46,603)	-	(46,603)
Net Outlays	**$170,626**	**$102,328**	**$272,954**

This statement is unaudited. See the accompanying independent auditors' report.

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

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

	Abandoned Mine Lands	Regulation and Technology	Total
Budgetary Resources			
Budget Authority			
Appropriations Received	$281,843	$105,188	$387,031
Unobligated Balance			
Beginning of Fiscal Year	48,793	4,731	53,524
Spending Authority From Offsetting Collections			
Earned			
Collected	111	1,062	1,173
Receivable From Federal Sources	(9)	45	36
Change in Unfilled Customer Orders Without Advance From Federal Sources	(40)	49	9
Subtotal: Spending Authority From Offsetting Collections	62	1,156	1,218
Recoveries of Prior Year Obligations	24,855	2,082	26,937
Temporarily Not Available Pursuant to Public Law	(1,467)	(1)	(1,468)
Permanently Not Available	-	(1,222)	(1,222)
Total Budgetary Resources	**$354,086**	**$111,934**	**$466,020**
Status of Budgetary Resources			
Obligations Incurred			
Direct	$316,553	$105,004	$421,557
Reimbursable	(51)	1,051	1,000
Total Obligations Incurred	316,502	106,055	422,557
Unobligated Balance			
Apportioned	37,584	1,788	39,372
Unobligated Balance not Available	-	4,091	4,091
Total Status of Budgetary Resources	**$354,086**	**$111,934**	**$466,020**
Relationship of Obligations to Outlays			
Obligations Incurred	$316,502	$106,055	$422,557
Obligated Balance, Net, Beginning of Fiscal Year	317,333	36,629	353,962
Obligated Balance, Net, End of Fiscal Year			
Accounts Receivable	-	53	53
Unfilled Customer Orders From Federal Sources	20	243	263
Undelivered Orders	(319,829)	(31,964)	(351,793)
Accounts Payable	(9,781)	(3,944)	(13,725)
Less: Spending Authority Adjustments	(24,806)	(2,176)	(26,982)
Outlays			
Disbursements	279,440	104,895	384,335
Collections	(111)	(1,062)	(1,173)
Subtotal	279,329	103,833	383,162
Less: Offsetting Receipts	(23,842)	-	(23,842)
Net Outlays	**$255,487**	**$103,833**	**$359,320**

This statement is unaudited. See the accompanying independent auditors' report.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

December 1, 2004

Memorandum

To: Director, Office of Surface Mining Reclamation and Enforcement

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

Subject: Independent Auditors' Report on the Office of Surface Mining Reclamation and Enforcement's Financial Statements for Fiscal Years 2004 and 2003 (Report No. C-IN-OSM-0065-2004)

We contracted with KPMG LLP (KPMG), an independent certified public accounting firm, to audit the Office of Surface Mining Reclamation and Enforcement's (OSM) financial statements for fiscal years 2004 and 2003. The contract required that KPMG conduct its audit in accordance with U.S. generally accepted government auditing standards; Office of Management and Budget Bulletin 01-02, as amended, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency *Financial Audit Manual.*

In its audit of OSM (Attachment), KPMG found that the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. As discussed in KPMG's report and Note 12 to the financial statements, OSM's fiscal year 2004 consolidated statement of net cost is not comparable to its fiscal year 2003 consolidated statement of net cost. This occurred because in fiscal year 2004, OSM revised the presentation of costs and revenues to match Government Performance and Results Act strategic plan applicable to fiscal year 2004, which is different from the plan applicable to fiscal year 2003.

KPMG noted no matters involving internal control over financial reporting that they considered to be material weaknesses. KPMG also found that OSM's financial management systems substantially complied with the *Federal Financial Management Improvement Act* (FFMIA). Excluding FFMIA, there were no reportable findings of noncompliance with laws and regulations tested during the audit.

KPMG is responsible for the attached auditors' report and for the conclusions expressed therein. We do not express an opinion on OSM's financial statements, conclusions on the effectiveness of internal controls, conclusions on whether OSM's financial management systems substantially complied with FFMIA, or conclusions on compliance with laws and regulations.

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

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

Attachment

ATTACHMENT

KPMG

KPMG LLP
Suite 2700
707 Seventeenth Street
Denver, CO 80202

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of the Office of Surface Mining Reclamation and Enforcement (OSM) as of September 30, 2004 and 2003, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended (hereinafter referred to as the "financial statements"). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered OSM's internal control over financial reporting and tested OSM's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements 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 OSM's financial statements as of and for the years ended September 30, 2004 and 2003 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the financial statements, OSM's fiscal year 2004 consolidated statement of net cost is not comparable to the fiscal year 2003 consolidated statement of net cost because of a change in the Government Performance and Results Act strategic plan.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters 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 following sections discuss our opinion on OSM's financial statements, our consideration of OSM's internal control over financial reporting, our tests of OSM's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the Office of Surface Mining Reclamation and Enforcement (OSM) as of September 30, 2004 and 2003, and the related consolidated statements of net costs, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of OSM as of September 30, 2004 and 2003, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the financial statements, OSM's fiscal year 2004 consolidated statement of net cost is not comparable to the fiscal year 2003 consolidated statement of net cost because, in fiscal year 2004, OSM revised the presentation of costs and revenues to match the Government Performance and Results Act strategic plan applicable to fiscal year 2004, which is different than the plan applicable to fiscal year 2003.

The information in the Management's Discussion and Analysis, on pages 1 through 85, and Required Supplementary Information, on pages 106 through 107, is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information, and accordingly, we express no opinion on it.

Internal Control Over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards issued by the American Institute of Certified Public Accountants. Material weaknesses are 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. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

A summary of the status of prior year findings 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 OSM in a separate letter dated October 31, 2004.

Compliance and Other Matters

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed no instances where OSM's financial management systems did not substantially comply with the three requirements discussed in the Responsibilities section of this report.

Responsibilities

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA) requires each Chief Financial Officer (CFO) Act 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, OSM prepares annual financial statements.

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparing the Management's Discussion and Analysis (including the performance measures), and required supplementary information; and
- Complying with laws, regulations, contracts, and grant agreements, including FFMIA.

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

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2004 and 2003 financial statements of OSM based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

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

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

In planning and performing our fiscal year 2004 audit, we considered OSM's internal control over financial reporting by obtaining an understanding of OSM's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. Also projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. In addition, our internal control testing may not be sufficient for other purposes. 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 section, 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 OSM's fiscal year 2004 financial statements are free of material misstatement, we performed tests of OSM's compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, regulations, contracts, and grant agreements applicable to OSM. Accordingly, noncompliance may occur and not be detected by these tests and such testing may not be sufficient for other purposes. Providing an opinion on compliance with laws, regulations, contracts, and grant agreements 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 OSM's financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

Distribution

This report is intended for the information and use of OSM's and the Department of the Interior's management, Department of the Interior's Office of Inspector General, the U.S. Government Accountability Office, 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

October 31, 2004

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Exhibit I

OFFICE OF SURFACE MINING

Summary of the Status of Prior Year Findings

September 30, 2004

Ref	Condition	Status
A	Security and Internal Control Over Information Technology Systems	The condition has been downgraded from a reportable condition in the prior year to a management letter comment in fiscal year 2004. Management letter comments are reported in a separate letter to management dated October 31, 2004.
B	Internal Control Over Charge Cards	The condition has been downgraded from a reportable condition in the prior year to a management letter comment in fiscal year 2004. Management letter comments are reported in a separate letter to management dated October 31, 2004.