

Excerpt from the minutes of the LB&A Committee meeting on 12/10/2020

**ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE**

Anchorage, Alaska
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SPECIAL AUDIT REQUEST

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CHAIR TUCK announced the next order of business would be a special audit request.

CHAIR TUCK said he and Representative Spohnholz were making the request regarding the Department of Revenue (DOR) oil and gas tax audit process. He invited Ken Alper to present the audit request to the committee.

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KEN ALPER, Staff, Representative Chris Tuck, Alaska State Legislature, said he may be referring to information in the committee packet. The first he noted was a special report on the Department of Revenue, oil and gas tax audit process, dated June 20, 2014. He also pointed to 11 pages, which start out with a cover letter to the co-chairs of the Senate Finance Committee, Senators Steadman and von Imhof, from the Department of Law (DOL), dated January 16, 2019.

MR. ALPER offered background information that in the last year, the Tax Division refused to provide Kris Curtis of the Legislative Audit Division some of the information that she is statutorily allowed to acquire, information specific to assessments and settlements. He continued:

That led to there being a qualified opinion - an asterisk in the statewide single audit - because of a lack of complete information coming from the Department of Revenue.

In addition there have been some requests for information that have been denied from individual legislators on the grounds that it was confidential.

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That is the sort of information that in the past years has been not considered confidential, and, in fact, there are specific statutory exceptions to that data being confidential, meaning aggregated data within the production tax.

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MR. ALPER covered the questions being asked in the special audit request, which he said fit into three broad categories. The first couple questions relate to updating the data in the 2014 legislative audit. He said, "We want to make sure that the production tax audit staffs and workloads are appropriate, that they have the right number of people that are adequately trained for the job, and that they have appropriately adapted to the advanced software that was, in 2014, still a work in progress but has been fully implemented in this part of their world." He said that project was funded in the fiscal year 2012 (FY 12) capital budget, \$34.7 million. Also being considered, he said, is whether the process of "going about the audits" has changed, what the priorities are, whether there have been changes to policy, reinterpretations of statute, different ways of making considerations, or changes to the way the tax is being collected.

MR. ALPER said the next broad area is the information that was missing in the statewide single audit, which he noted are items four and five on the audit request memorandum. He said there was a question as to whether tax audit assessments may have been paid using tax credit certificates. He reviewed, "There is a large overhang of unpurchased tax credit certificates that in the past the state used to buy as quickly as they came in. They're now seven-hundred-and-some million dollars outstanding." He continued:

There was some concern that a major producer that might have a tax audit assessment might be purchasing those credits and using it to pay their taxes. There's no proof of this, but there's also no information to show that it's not being done, which is where Ms. Curtis' concerns were. And were that to take place, there's a constitutional issue, and the reason for that is the [Alaska] Supreme Court has determined that a production tax audit assessment ... is an administrative proceeding, the result of which has to go into the Constitutional Budget Reserve. ... So, if a tax audit is being paid for with tax credits,

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which is a general fund revenue source, ... it would be an unconstitutional diversion of money ... from the Constitutional Budget Reserve without a three-quarter vote, and that would be problematic. So, we need to find out if that sort of thing is taking place.

MR. ALPER said the missing piece to which Ms. Curtis has not been provided access pertains to audit settlement memorandums regarding disputes and formal processes signed by the commissioner of the Department of Revenue (DOR). Without those, Ms. Curtis has not been able to "get enough information to resolve that." He said there are also questions of whether taxes are being refiled or settled in advance of a formal audit assessment request as a way to circumvent the Capital Budget Reserve Fund (CBRF) issue in an attempt to get certain monies into the general fund. He said it is necessary to find out whether deals or settlements are being made on the side.

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MR. ALPER stated that that final series of questions on the memorandum, items six and seven, have to do with specific data coming out of DOR "that more involves numbers." He continued:

Although the individual taxes and individual tax assessments on a particular tax payer is clearly confidential - these are [Internal Revenue Service] (IRS) rules, state rules - there are exceptions in statute, specifically AS 43.55.890, that allow for aggregated information. If there's at least three tax payers, at least three data points, ... the administration's allowed to share with the public and the legislature the total. That keeps individual data confidential, and here we're talking about taxes, lease expenditure data; lots of specific data about the oil and gas operations and spending can be released in an aggregated form.

We have information on total tax assessments for every audit cycle going back to at least 2000. From 2000 to 2007, the legislative auditor published in the 2014 special audit what the sum total was.

MR. ALPER noted he was the tax director during some of this time, and every time a tax audit cycle was completed a memorandum was published showing the total amount assessed and the total amount with interest. There is a complete data set

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through 2012. He said in the last two years DOR has completed the 2013 audit cycle and is close to or may have already completed the 2014 cycle and has declined to share the information on the total audit assessment, saying that is confidential information. He relayed that item six in the memorandum seeks to get that information from DOR.

MR. ALPER said item seven in the memorandum seeks to update the information referred to previously that says of the assessed dollars how much remains outstanding and in what category: the appeals process, in the Office of Administrative Hearings, or in court. He related that Representative Story, who had made some of these requests, received an e-mail from DOR in October [2020] stating that there are no outstanding assessments through 2013. He said that was surprising information. He pointed out there was an error in item seven, which refers to \$1.3 billion in open assessments. He explained that the \$1.3 billion includes some assessments that had previously been paid. He said the real number, through 2012, is approximately \$900 million known, unpaid assessments outstanding as of January 2019. Mr. Alper said there is also an unknown number that came in for the 2013 cycle, which is, based on recent activity, likely \$100-\$200 million. He continued:

So, there's a billion dollars, or so, worth of outstanding audited assessments that are no longer pending. ... In some way they have been settled or resolved, which then leads to, "Well, what happened?" Without the auditor having access to the settlement memos, we don't know what happened. The only thing we could piece together is what we know is money that went into the Constitutional Budget Reserve.

The Constitutional Budget Reserve data exists in two different forms. You could see the total number in the revenue sources book. That number includes money coming in from multiple sources: royalty audits, oil property tax, corporate income tax, mining taxes, as well as the oil and gas production tax. The Department of Revenue puts out an annual report that - to the extent they can - breaks that out by source. So, for 2019, the annual report is complete, and we know that \$166 million, resulting from the production tax, went into the CBRF. For FY 20 the annual report isn't out yet, but we know from the revenue sources book that \$235 million total went to the CBRF, some large portion of which would've come from the

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production tax. So, we've got a universe of something approaching, but not quite, \$400 million that likely came from production tax settlements. Out of a billion, billion-one worth of original audits.

So, the last part of this request is to try to find out what happened. Was there a change in policy? Was there a master settlement across the board? ... Why is it that all of these audits may have only been settled for 35-40 cents on the dollar?

MR. ALPER said that concluded his presentation, and he offered to answer questions.

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REPRESENTATIVE JOSEPHSON asked why Mr. Alper thinks the administration would respond any differently from how it responded to Ms. Curtis.

MR. ALPER explained that the single audit process is confidential, and the administration refused the request of Ms. Curtis claiming confidentiality. He expressed his hope that the special audit may "shake something loose over there." If not, the next step may be more adversarial; however, he expressed his hope that it would not come to that.

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SENATOR STEDMAN asked Ms. Curtis to confirm she is the auditor for the state.

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KRIS CURTIS, Legislative Auditor, Legislative Audit Division, Legislative Agencies and Offices, confirmed she is the legislative auditor. In response to a follow-up question as to whether [DOR] comes under her purview, she stated that her position is a constitutional one, and under statute, she has access to "all information, including that which is confidential." She further confirmed that the confidential information allows her to do her job as auditor.

SENATOR STEDMAN then expressed that he expects the situation to get elevated. He said he would like to know what the next step would be to protect "the integrity of the financial information that the legislature and the public has preview to."

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CHAIR TUCK remarked that he interpreted Senator Stedman's good question as being a rhetorical one.

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MS. CURTIS said most of the issues she is addressing pertain to whether the information she is requesting is privileged. The current administration has denied the Legislative Audit Division access based on the issue of privileged information; the division has not had this issue with past administrations. [The current administration] claims that the information Ms. Curtis says she needs in order for the Legislative Audit Division to answer some questions is attorney/client privileged. She said, "Those are the types of things we're going to have to figure out in this process."

SENATOR STEDMAN asked what the next step is to ensure the books can be reviewed to make sure they're "clean."

MS. CURTIS answered that the Legislative Budget and Audit Committee has subpoena power. She offered her understanding that the committee had never exercised this power. She expressed her hope that "we can work together to come to some understanding of what is or is not in my purview." She said another option is that the legislature could specifically state that she has access to privileged information.

SENATOR STEDMAN stated his concern that "there's nobody watching the hen house" and billions of dollars are involved. He said the public and the legislature need to have assurance that the transactions are documented, justified, in proper form, and reported within "our financial statements" so that the legislature, as policy makers, can understand the benefits and possible pitfalls in any policy pursued. He emphasized the significance of this issue, and he said his comfort level is not high. He questioned who, if not the legislative auditor, is allowed to review the information.

MS. CURTIS responded that if Senator Stedman is referring to the tax credits, the division can review what is in the accounting system, and some documents that the department doesn't view as privileged, thus it has some understanding of what is in the financial statements. She clarified that in 2019, [the administration] was not allowing the Legislative Audit Division access to the administration's subsystem and, when asked for specific information to follow up on the assessment issue, was

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not responsive. She added, "That lead to a qualification. We are still in progress for the FY 20."

SENATOR STEDMAN questioned how, without an audit, the public is assured there has been no quid pro quo in dealing with settlements of credits.

MS. CURTIS answered, "I think that's what this [special] audit can provide: assurance."

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SENATOR VON IMHOF expressed interest in hearing about cash value. She said she wants to know, for example, the cash value when a certificate is used for a tax payment.

MS. CURTIS asked Senator von Imhof to clarify if she wanted to know whether the state paid, for example, 80 cents on the dollar for a \$100 credit.

SENATOR VON IMHOF emphasized, "The most important thing of all is the flow of cash." She said she did her best to follow Mr. Alper's rapid presentation of a great amount of information. She stated that she wants to know where the cash flow went and what was left on the table - "things like that." She allowed that she may not be phrasing the question just right, and she suggested she could speak with Ms. Curtis later. She recalled that Senator Stedman had spoken about the accountability of the tax credits, and she reemphasized her interest in the matter of cash flow.

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SENATOR GIESSEL, regarding Senator Stedman's comment about transparency to the public, remarked that the legislature is the public, having been elected by the public and representing it. She said there has been a multi-level erosion of legislative authority in the last two years. Regarding the two-page special audit request, she turned to item 4, tax credits, and stated that in House Bill 111, [passed during the Thirtieth Alaska State Legislature], legislative intent was articulated that credits could be used to "satisfy a tax, interest, penalty, fee, or other charge" that has not been subject to ["an administrative 19 proceeding or litigation."] She pointed to the final sentence of item 5 of the special audit request, which read:

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As part of this analysis, determine whether the state is entering into any form of agreement with the tax payer outside of the audit assessment process that could be interpreted to be part of an administrative proceeding.

SENATOR GIESSEL said, "That, of course is something that we've allowed them to do." She said Mr. Alper, during his time as the Tax Division director issued an advisory document resulting in "a need for the companies to revise their tax filings." She stated, "Sometimes reading some of these implies that tax payers have been unscrupulous, and sometimes it's allowed." She explained she brought that up as "a modifying statement related to the questions." She expressed that she shares the concern that the legislative branch and the public are being "pushed to the side."

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REPRESENTATIVE JOSEPHSON offered his understanding that Ms. Curtis had said there is a law that can be triggered that finds the legislative auditor is allowed to view privileged information, which, in other words, meant that a legal fix is not needed because there is a law that applies.

MS. CURTIS answered no. She stated that she had said one option would be to clarify her ability to look at privileged information by changing the law.

REPRESENTATIVE JOSEPHSON surmised that a settlement memorandum is likely to give the statistics of a full and final settlement, along with some legal jargon, but may not get into the merits of a full dispute.

MS. CURTIS said she thought Representative Johnson was saying that evaluating what is happening would involve "a deep dive into communications between the state and the auditee." She confirmed that is true, because it is never simple. It involves looking at all the information available, because an auditor cannot give a full judgement by viewing a fraction of the whole.

REPRESENTATIVE JOSEPHSON, to Mr. Alper, recalled Senator Giessel had noted that [House] Bill 111 allowed for some offsetting. He asked whether there were any constitutional problems with House Bill 111.

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MR. ALPER answered that tax credits can be used to pay a tax obligation from a prior year, but "only so long as that obligation would not have to go to the CBRF." He said that led to the question: "What would that be, for example?" That led further to the idea that an additional tax due as a result of a tariff settlement perhaps should not be CBRF money. He said there had been a large Federal Energy Regulatory Commission (FERC) settlement pending at the time House Bill 111 passed, which led to several hundred million dollars in incremental taxes becoming due. He said, "We thought perhaps that was the sort of thing that might be payable with tax credits." He said working with Senator Giessel on that bill, the goal was to create a secondary market for tax credits. He said, "We needed to find a way, with the state not providing the cash, that we would be able to allow these holders of credits to use them. One way would be to sell them. So, we thought that perhaps these tariff settlements might be something outside the CBRF universe." Mr. Alper said that led to some reclassifying of previous deposits to the CBRF, with which the legislative auditor found fault, and there is an approximate \$1.2 billion discrepancy outside the scope of this audit, which is not "so-called real money" but is "a definition of what we owe back to the CBRF." Mr. Alper said the short answer to Representative Josephson's question is that yes, House Bill 111 "allows us to go back into time," but only to the extent that the underlying obligation would not be CBRF revenue.

REPRESENTATIVE JOSEPHSON said there is some belief that an aggressive posture would have brought the state \$1.1 billion, "but we see indications that \$400 million was paid." He said, "That's a \$1,000 dividend, and the public may want to know about that." He indicated that the public may "misunderstand that; it may be that the oil tax payer arguments were good ones."

MR. ALPER said the total amount of assessments sounds large, but he advised keeping in mind just how large the oil and gas production tax is within the State of Alaska's overall revenue portfolio. It is traditionally the largest revenue item. He related that between 2006 and 2012, approximately \$29 billion in production tax was collected by the state - all in general fund revenue. He said the entirety of the auditor assessments for those seven years, including the amount paid before the memorandum was written, was approximately \$1.5 billion. He said that is an increment of roughly 5 percent in unpaid taxes found by DOR. He echoed Representative Josephson's remark that that

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amount equals \$1,500 for every person in the state, "a billion dollars outstanding."

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SENATOR BISHOP observed that Ms. Curtis was not asking for any more or less than has been in her purview, and he opined that the committee should back her up to be afforded the information for the public.

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SENATOR BISHOP moved that the Legislative Budget and Audit Committee approve the request for a special audit of the Department of Revenue oil and gas tax audit process made by Representatives Tuck and Spohnholz. There being no objection, it was so ordered.