

ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE
Anchorage, Alaska
January 12, 2009
9:05 a.m.

MEMBERS PRESENT

Representative Ralph Samuels, Chair
Representative Mike Doogan
Representative Mike Hawker
Representative Mike Kelly (via teleconference)
Representative Kevin Meyer (alternate)

Senator Bert Stedman
Senator Gene Therriault
Senator Charlie Huggins (alternate)

MEMBERS ABSENT

Senator Lyman Hoffman, Vice Chair
Representative Mike Chenault
Representative Reggie Joule (alternate)
Senator Johnny Ellis
Senator Lyda Green

COMMITTEE CALENDAR

APPROVAL OF MINUTES

GAS FISCAL DESIGN ADDITIONAL INFORMATION: DAN DICKINSON AND
DAVID WOOD

DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT - PUBLIC SCHOOL
PERFORMANCE INCENTIVE PROGRAM: EDDY JEANS

EXECUTIVE SESSION

FINAL AUDIT - DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC
DEVELOPMENT, BOARD OF PUBLIC ACCOUNTANCY - SUNSET

OTHER COMMITTEE BUSINESS

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

DAN E. DICKINSON, CPA, Consultant
to the Legislative Budget and Audit (JBUD) Committee
Alaska State Legislature

Anchorage, Alaska

POSITION STATEMENT: Presented answers to questions asked by committee members at the last meeting regarding oil and gas taxation.

DAVID WOOD, PhD, Consultant
to the Legislative Budget and Audit (JBUD) Committee
Alaska State Legislature
Lincoln, United Kingdom

POSITION STATEMENT: Explained a series of slides and presented answers to questions asked by committee members at the last meeting regarding oil and gas taxation.

EDDY JEANS, Director
School Finance and Facilities Section
Department of Education and Early Development (EED)
Juneau, Alaska

POSITION STATEMENT: Presented a report regarding the Public School Performance Incentive Program.

CAROL COMEAU, Superintendent
Anchorage School District (ASD)
Anchorage, Alaska

POSITION STATEMENT: Testified during the hearing on the Public School Performance Incentive Program.

PAT DAVIDSON, Legislative Auditor
Legislative Audit Division
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Provided information on the final audit for the Department of Commerce, Community, & Economic Development, Board of Public Accountancy - Sunset.

CHERYL SUTTON, Staff
to Representative Ralph Samuels
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Provided information on regarding a Reimbursable Service Agreement to the Department of Natural Resources

ACTION NARRATIVE

[9:05:21 AM](#)

CHAIR RALPH SAMUELS called the Legislative Budget and Audit Committee meeting to order at 9:05 a.m. Present at the call to order were Representatives Doogan, Hawker, and Meyer and Senators Stedman and Huggins. Representative Kelly and Senator Therriault arrived as the meeting was in progress.

APPROVAL OF MINUTES

[9:06:36 AM](#)

SENATOR STEDMAN made a motion to approve the minutes of [December 9, 2008, and December 10, 2008,] as presented. There being no objection, the minutes of December 9, 2008, and December 10, 2008, were approved.

GAS FISCAL DESIGN ADDITIONAL INFORMATION

[9:06:47 AM](#)

CHAIR SAMUELS announced that Mr. Dan Dickinson and Dr. David Wood will present answers to questions asked by members at the last committee meeting regarding oil and gas taxation. He said Mr. Dickinson will also present some price forecasting scenarios.

[9:07:23 AM](#)

DAN E. DICKINSON, CPA, Consultant to the Legislative Budget and Audit (JBUD) Committee, Alaska State Legislature, discussed the interactive model he prepared for the committee using the computer program Excel. The variables in the model can be changed to see what happens to the tax flow, he explained. The model shows that when there is a gasline some years from now the state's production taxes will go down, not up, because of peculiarities in the way the tax is defined.

[9:09:30 AM](#)

MR. DICKINSON walked the committee through the modeling methodology [slides 1-3 entitled, "Combined Progressivity Example"]. The variables that can be changed are the daily volume of oil and gas production, the Alaska North Slope West Coast (ANS WC) and Henry Hub prices, the transportation to market costs, and the upstream costs, he pointed out. Calculation of the production tax value (PTV) includes the upstream costs, he continued, and when oil production is lower the upstream costs will likely be lower.

CHAIR SAMUELS inquired whether lower oil production always means lower upstream costs given that there are fixed costs.

MR. DICKINSON acknowledged that this is a good point. A big field will have much more cost and a small field will only have so much cost, he said. However, there are times when a company is making huge investments, such as when it is turning a small field into a large one.

MR. DICKINSON continued explaining the modeling methodology. He said the model is set up such that the gas values have a limit, i.e. the model looks at the number of dollars per million cubic feet (MCF), while the oil is set at a total figure that can be taken out of the DOR Revenue Sources Book.

9:11:25 AM

MR. DICKINSON ran through an example with a PTV per barrel of oil equivalent (BOE) of \$55. At a trigger point of \$30, this scenario leaves \$25 subject to progressivity, generating an additional 10 percent tax rate, he said. The 25 percent base tax rate combined with the 10 percent progressivity rate results in a total tax rate of 35 percent, generating a tax revenue of \$4.3 billion.

9:12:16 AM

MR. DICKINSON next presented a modeling scenario with gas production of 4.4 billion cubic feet (BCF) per day, a Henry Hub price of \$6 per MCF, a \$.75 adjustment that was used in the TransCanada proposal, and a transportation to market cost of \$2.75. This comes out to about \$2.50 per MCF, he said, and this is multiplied times the volume, resulting in a PTV of about \$3.5 billion. In this scenario, he continued, the oil and gas streams are not calculated separately; they are combined into BOE. So, the BOE for the gas is 500 million which equals a BOE of \$35 per barrel. At a trigger point of \$30, this leaves \$5 subject to progressivity, generating an additional 2 percent tax rate. The 25 percent base tax combined with the 2 percent progressivity tax results in a tax rate of 27 percent. The tax revenue in this combined oil and gas scenario is about \$4.2 billion, a decrease of about \$100 million from the oil-only scenario, he said.

9:14:17 AM

MR. DICKINSON demonstrated how changing the oil price variable from \$55 per barrel to \$135 would generate a tax revenue to the state of \$12 billion in an oil-only scenario. He then added gas to the model at a price of \$6 and explained that, in this combined oil and gas scenario, the total production tax revenue would drop to \$10.7 billion.

9:15:52 AM

MR. DICKINSON referenced discussion from a month ago in which he had said the state's total revenue would drop [as a result of combined oil and gas taxation] and Chair Samuels had said that that would not be the case because there would be higher royalties and higher income taxes. Using the model, Mr. Dickinson demonstrated that the increase in gas royalty would still not cover up the deficit. The increased income and property taxes from gas production might possibly make up that difference, he said, but it could be that the state's total revenue does go down.

9:16:23 AM

SENATOR STEDMAN surmised that since oil taxes are monthly, looking at a certain price for one month will give a good guesstimate on the effects of that incremental month versus using that price for an entire year.

MR. DICKINSON responded, "Absolutely." The model will calculate monthly figures when the variable for days per year is changed from 365 to 30, he said. He acknowledged that Senator Stedman is correct in a sense because the model has taken what is a monthly calculation and turned it into a constant for the entire year.

9:17:13 AM

SENATOR STEDMAN presumed that the point is to determine the magnitude and direction of what is going to happen and not so much the actual numerics.

MR. DICKINSON replied that a lot of the elements have been removed from the calculation, but what he is trying to illustrate is that the revenues could go down significantly by the act of adding gas.

9:17:35 AM

SENATOR STEDMAN requested Mr. Dickinson to touch again on the barrel of oil equivalent and the upstream costs being zeroed out in the gas column in the model.

MR. DICKINSON explained that 6000 cubic feet of gas has the same number of BTUs as a barrel of oil. The law establishes that relationship, he said; but, in the market, that same economic relationship does not always hold. He said he thinks the legislature was confident in adopting it because it had held roughly constant for a number of years; however, this has not been the case in the last couple of years. As the economics of moving oil and gas around change, the premium people are willing to pay for liquidity change, he continued. Thus, under the [6:1 ratio] established in law, selling 6000 cubic feet of gas at \$6 per MCF is equivalent to selling a \$36 barrel of oil. This means that if oil is selling at \$135 a barrel, it is more like a 15:1 than a 6:1 ratio.

[9:19:24 AM](#)

MR. DICKINSON, regarding Senator Stedman's second point, said he used Prudhoe Bay in his model which already has a central gas facility. Thus, this gas is essentially ready to go into a gas line, he continued, although right now it goes back down into the ground to keep up enough pressure to produce oil. So, when folks are ready to sell gas from Prudhoe Bay the incremental costs up to that central gas facility will be very small. However, this may not be true in a new gas field, he allowed. He said that in this Prudhoe Bay scenario, the gas costs are an allocation issue. For example, if it costs \$4 billion to run Prudhoe Bay, the cost assigned to oil can be lowered by assigning some of that cost to gas. He explained that this spreadsheet is set up so that as gas cost increases it comes out of the oil cost. But, he continued, one could independently choose to increase the oil cost and leave the gas alone. Fundamentally, it does not change the equation that much, but what it does change is the royalty calculation.

[9:21:08 AM](#)

CHAIR SAMUELS interjected that it does not matter how the costs are allocated because the progressivity and BOE are together in one pool. The point of Mr. Dickinson's example is that only if the costs are separated and then evaluated with different schemes you get a different answer than if they are treated together as under the current law.

MR. DICKINSON answered, "Correct." If the same parameters are left in place, but the oil and gas streams are cataloged separately so there is no cross subsidization, then that number would be affected by how costs are divided between oil and gas.

[9:21:46 AM](#)

SENATOR STEDMAN asked Mr. Dickinson to address the issue of capital credit because that is a significant deduction.

MR. DICKINSON reiterated that to simplify and keep to one screen, he left some things out of the document, including capital credits. The model calculates the taxes before credits, he said.

[9:22:21 AM](#)

MR. DICKINSON noted that the incentive to producers to produce gas as a way to bring down their taxes has been an issue. However, he said, if the gas price rises to \$13 and the oil price stays the same, the 6:1 ratio is violated in the other direction. A tax should last 30-40 years, the life of the gasline, he said. He then inserted this scenario into the model and calculated that oil alone would generate \$5 billion in revenue and \$4 billion would be added to that by the gas. So, in this case, adding gas nearly doubles the tax, he said. Sometimes adding gas will raise the tax and sometimes it will lower the tax.

[9:24:53 AM](#)

CHAIR SAMUELS questioned the number of barrels per day used in the aforementioned scenario.

MR. DICKINSON said he used 700,000 barrels a day. He clarified that this is a little bit lower because he has moved a lot of cost over to gas. He re-manipulated the model by putting the cost back up to the \$4 billion level and calculated there would be about \$4 billion in tax revenue.

[9:25:34 AM](#)

MR. DICKINSON expressed his concern that there might be a great hue and cry if people are expecting the dollars to go up as a result of the gasline but instead they go down. Or, other folks may be expecting it to be a subsidy and then the producers come back saying that under current price conditions they will be

paying a huge addition. He warned that folks need to understand which of those things they are trying to do.

9:26:05 AM

REPRESENTATIVE DOOGAN asked whether the assumptions built into the oil pricing on the left hand side of the example include the standard deduction for oil field costs.

MR. DICKINSON said that would affect the \$4 billion. If the state thought that that was decreasing what companies were deducting, it would have to move that down a little bit, he advised. And, if the state thought it was increasing what companies were deducting because of falling volumes then it would have to move that up a little bit. There is no direct way of plugging that in because this is an amalgamation of a lot of numbers together. But, yes, the state could recognize that, he said.

9:27:13 AM

CHAIR SAMUELS informed members there will soon be an Excel spreadsheet on the committee's website that can be manipulated. Members will be able to manipulate the volume of gas, volume of oil, the price, [upstream] costs, and the transportation costs to see what happens.

MR. DICKINSON noted that the version currently posted on the website is a PDF version so it cannot be manipulated.

CHAIR SAMUELS stated that a way will be figured out for members and the public to be able to manipulate the various mechanisms.

9:28:09 AM

MR. DICKINSON moved to his illustrations demonstrating what happens when gas PTV per BOE and oil PTV per BOE are put together. He said the line on the graph defines the point at which there would be no effect from adding gas. Above the line represents higher production tax revenues with added gas, and below the line represents lower production tax revenues with added gas. For the data points on the graph, he said he used actual sales minus actual transportation costs for the oil for the years 2004-2008. For the upstream gas cost he used the tariff suggested by TransCanada which was in the range of \$2.40, although the tariff suggested by Black & Veatch was about double that in the \$4.80 range. This gives a historical sense of where

points have fallen out, he said. In general, it can be seen that there will be higher revenues as a consequence of adding a gasline - if the past is a good predictor of the future. However, it will be a situation of subsidy if the tariff is what Black & Veatch predicted.

[9:30:17 AM](#)

MR. DICKINSON said his point is that if folks think it should be one way or the other, right now it could be either way. He noted that on the graph he took oil PTV's all the way out to \$400 a barrel, since this is about a 30 year stability on a gasline. What is important is that the breakeven point keeps changing, he said. Sometimes making an investment will move the state from a situation of higher taxes to lower taxes and sometimes that investment will move the state from lower taxes to higher taxes. There are some very odd things that have to do with the flex points built into the law, he advised. At each of the cusp points on the graph, what happens to the tax as the price or PTV are raised or lowered - and that can happen as a consequence of investment - changes.

[9:33:07 AM](#)

DAVID WOOD, PhD, Consultant to the Legislative Budget and Audit (JBUD) Committee, Alaska State Legislature, directed attention to a slide presentation entitled, "Reponses to Questions from LB&A asked on December 9th and 10th, 2008." He referred to slide 2, which shows the impact of natural gas on combined oil and gas production tax. Dr. Wood said he thinks his approach complements Mr. Dickinson's approach. He explained that he has studied a wide range of oil and gas production tax values to ascertain their affect in either increasing or decreasing the ultimate production taxes paid. He said he found that the magnitude of difference between the value of the oil production tax stream and the gas production tax stream is important relative to flex or cusp points in tax law. Dr. Wood said two other factors are of importance: the relative volumes of gas and oil are going to have an impact; and the amount of PTV reinvested can have a significant impact on the combined tax paid.

[9:34:29 AM](#)

DR. WOOD moved on to a graph on slide 3, which depicts ["Natural Gas Dilution Effects on Combined Oil & Gas Production Tax."] He pointed out that the horizontal axis shows the production tax

value for oil, while the vertical axis shows the increase or decrease of the overall amount of tax paid as a result of adding gas to an oil production tax stream. Anything above the zero point depicts an increase, while anything below it shows a decrease of that tax. The various lines on the graph represent different gas production tax values. The lowest line is a \$5 BOE gas production tax value. Most of the curve lies below the zero line and becomes more negative as tax production values increase. He explained, "As you get a greater disparity between the low gas price and a high oil price, you're increasing that dilution effect of the gas." He said a \$75 BOE production gas value line "only just catches a negative" at approximately \$342.

[9:36:46 AM](#)

DR. WOOD said it is interesting that between the \$20 and \$40 gas production tax value lines there are areas that fluctuate between positive and negative "as we get that disparity between a gas production tax value and an oil production tax value." At that point, he said, it becomes clear that it is becoming quite difficult to predict variations in the impact of gas on oil. Most of the numbers on the right-hand side of the graph don't reflect the kind of oil and gas values that have been seen historically; however, at some point in the future, "we may well move into some of those territories." Dr. Wood said it is important to understand that the impact of gas on oil stream is quite complicated and is related to that structure of progressivity.

[9:38:15 AM](#)

CHAIR SAMUELS said, "The best case scenario is 10 years for gas - probably closer to 15." He said there was a 4 percent decline in Prudhoe Bay this year, which he characterized as a good year. He predicted that within 10 years the state will be at 400,000 barrels a day, the tariff per unit will be higher because the fixed cost of Alyeska Pipeline Service Company will not drop proportionally, the volume of oil will be low, and the cost per unit will probably go up. He asked Mr. Dickinson to use that prediction and calculate the following into it: \$40, \$80, and \$100 a barrel. He added that he would like Mr. Dickinson to start off using a presumption of zero gas.

[9:40:01 AM](#)

MR. DICKINSON outlined the following: 450,000 barrels a day, \$80 a barrel, and \$8.00 transportation to market. In response

to Chair Samuels, he said transportation is currently about \$6.00. He said he thinks there is a general presumption that the state would prevail "on a low-cost mechanism." He said the carriers are not necessarily going to agree with that.

CHAIR SAMUELS asked if Mr. Dickinson thinks the cost will drop when everything is "depreciated out."

MR. DICKINSON said that is certainly a possibly, although he said he does not know if that is a likely scenario. Returning to Chair Samuel's previous request, he said there would be about a \$2 billion tax on \$80 a barrel, whereas for \$40 a barrel, [tax] would be about \$240 million.

[9:41:56 AM](#)

MR. DICKINSON, referring to [slide 3], previously shown by Dr. Wood, said it is possible to predict "what each of those lines that changes the cusp is"; however, what is unpredictable are the small changes, which can have bizarre results. It is a complex set of interactions, he explained, and "the things that are changing the tax may not be the determinants that you want tax changed by."

[9:43:38 AM](#)

SENATOR STEDMAN concluded that the combination of a high value of oil - because there is less of it - and a lower value of gas - because there is more of it - will result in virtually no net revenue off a gasline.

MR. DICKINSON concurred.

SENATOR STEDMAN posited that waiting for "first gas" may not be the best option.

MR. DICKINSON responded that there are ways to fix the problem that would make the amount of tax generated by the gas more predictable and may not tie it directly to the price of oil at the time.

[9:44:36 AM](#)

DR. WOOD noted that a number of the slides he is presenting "also draw attention to the fact that the amount of production tax value that is reinvested will also have an impact on this dilution effect on oil stream."

[9:45:23 AM](#)

DR. WOOD returned to discussion of the slides. He drew attention to slide 7, entitled, "Marginal Production Tax Rates Seen by a Producer for Reinvestment Dollars." The graph on slide 7 has a horizontal axis that shows the production tax value of the revenue stream. Regarding the reinvestment of the producer, he said, "We can see that there would be quite different impacts on our marginal production tax rate, depending on that production tax value." He noted that around the \$90 production tax value there is a high point that actually goes above 100 percent at \$342. That, he said, is less important than the fact that the graph shows lines crossing over peaks at different points, and those lines represent different percentages of reinvestment. The point, he said, is that it is very difficult to determine what exactly will be "the impact of investment on the taxation position," whether looked at from the perspective of the State of Alaska or the producer.

[9:47:38 AM](#)

DR. WOOD moved on to slide 8, entitled, "Implications of Analysis." He spoke of the relationships being non-linear. He said the magnitude of the variation would be influenced by a number of factors. Without detailed analysis, it is difficult to say whether a particular combination of volumes and budgeted values will lead to a positive or negative tax outcome.

[9:49:15 AM](#)

DR. WOOD presented slide 9. He concluded that under the current production tax rules known as the combined progressivity tax rules (CPT), the impact of a gas revenue stream makes tax planning quite difficult. One of the issues is whether it is a stable tax structure over the long term. In a situation where gas does significantly dilute the revenue stream, the consequences are that there will be a strong incentive to change the tax mechanism and that may need to be done several times which may lead to fiscal instability. In addition, by separating out that combined production tax approach, splitting the revenue streams into a gas and an oil revenue stream and calculating the production taxes independently will be a way to simplify the process and make it more predictable and stable. This approach is also flexible in the sense that incentives could be placed on the gas stream, focused on specific situations, and separated from the oil stream. He opined that

as a result, the cost analysis would be slightly more difficult, but it is a small price to pay for a simplified taxation structure.

[9:51:36 AM](#)

DR. WOOD moved to slide 10. He explained that the final slide points out that the work on the two models has identified some of the issues with the existing structure. The work presented in December was focused on how a fiscal design could be structured for the yet-to-find (YTF) future gas reserves. He expressed his belief that there was value in doing analysis on the existing proven reserves of Prudhoe Bay and Point Thomson on a multi-year basis. This would establish, not only how it looks in the current fiscal structure, but how might it look with alternative structures separating out gas and oil, and with different development scenarios and gasoline alternatives such as liquefied natural gas (LNG). He stressed that the work presented in December was based on hypothetical fields over multiple years and is useful to look at exploration and future production potential; however, tax planning analysis must include the proved reserves as well.

[9:53:37 AM](#)

DR. WOOD continued to explain that another aspect is to look at the fiscal design of Alaska and compare it with the fiscal design of a number of the main gas producing states in the Lower 48. Although those gas resources are quite different, there is lots of investment going into non-conventional gas such as shale gas, and different states are establishing different incentives to encourage investment. Dr. Wood predicted that in the next decade Alaska's gas will be competing with those gas projects and the fiscal design of other projects in the U.S.

[9:54:34 AM](#)

DR. WOOD ended his presentation.

[9:54:43 AM](#)

CHAIR SAMUELS said he would like to set up another scenario.

MR. DICKINSON recommended that Chair Samuels, while describing another scenario, remember that as people look for gas, they will find oil; therefore, 450 [barrels per day] may not be an "out-of-the-range, high point."

[9:55:57 AM](#)

CHAIR SAMUELS, using the figure of 450 barrels per day, described another scenario in which every broad-based tax was instituted, the entire permanent fund dividend was taken away, there was a zero tariff and one-third the current cost at Prudhoe Bay, and "we still didn't make it." He asked if that is an unfair assessment of what it will be like in ten years.

MR. DICKINSON responded by noting that the Revenue Sources Book says that in fiscal year 2010, at \$40 a barrel for oil, all general fund revenues combined will be approximately \$2 billion.

CHAIR SAMUELS observed, "That's at 700,000 barrels a day."

MR. DICKINSON responded, "That was [650,000 barrels a day]."

[9:58:16 AM](#)

CHAIR SAMUELS emphasized that each time he runs the numbers he concludes: "You can't make it, unless you get gas."

SENATOR STEDMAN stated that there is no incentive to get gas if there is no net revenue. Another issue, he remarked, is that there are other tax mechanisms available to fall back on "if that scenario does produce itself in our future."

[9:59:19 AM](#)

SENATOR HUGGINS said Commissioner Galvin maintains that the administration is not convinced that there needs to be an adjustment to Alaska's Clear and Equitable Share (ACES). He asked Mr. Dickinson if he has talked to "them" about the differential between analyses.

MR. DICKINSON said he held some preliminary conversations last month, and the general notion was that total taxes would be falling to be close to the oil-only tax, thus there would be a large incentive built in. He said the producers had not indicated that there should be a different kind of incentive. He surmised that Dr. Wood's point is that if you separate oil and gas, and you build certain things that have gas-only progressivity that is more predictable and oil-only progressivity that is more predictable it may end up having higher revenues or a higher bite. But, if it's more predictable and it's more

tied to what a producer does so the producer understands what will happen with investment, that may in some senses be a better situation for a producer than one saying there's a fairly large random element in the tax that will result.

[10:00:58 AM](#)

SENATOR HUGGINS opined that the average Alaskan, the state, and the producers want a system that is predictable.

MR. DICKINSON agreed and expressed his belief that in some ranges the predictability is more important than the "overall amount of the take".

[10:01:18 AM](#)

REPRESENTATIVE DOOGAN questioned how to construct a predictable tax on a commodity which had decreased in value by two-thirds in the prior six months.

MR. DICKINSON agreed with the difficulty, but suggested that revenue prediction for an investor differs from budget prediction.

REPRESENTATIVE DOOGAN disagreed and stated that predictable revenue is based on price assumption.

MR. DICKINSON clarified that an investor might be comfortable knowing that "X amount" of their profit is allocated to taxes. He pointed out that the budget prediction dilemma is in not knowing the amount of profit.

[10:02:21 AM](#)

CHAIR SAMUELS surmised that if the government perceived budget prediction as a problem to be fixed, there would be a need to review the cost allocations and the tax rate.

MR. DICKINSON said flex points would be a third consideration. He offered his belief that the same flex points would not apply to gas as apply to oil. He opined that it is difficult to understand a barrels of oil equivalent number that includes millions of cubic feet and a mathematical formula. He offered his belief that it is difficult for many people to understand whether a BOE number is high or low, hence it is difficult to discuss progressivity on gas.

[10:03:47 AM](#)

MR. DICKINSON suggested that if there is concern that 90 percent of the budget is determined by a highly volatile mechanism, the solution is to create a buffer mechanism such as a fund into which all oil and gas revenues go and from which there is a method of stable payouts for revenue.

CHAIR SAMUELS laughingly noted that this was attempted during the past year.

MR. DICKINSON said that only pursuing a tax method solution may not be a broad enough quest.

CHAIR SAMUELS quipped that the state would not be 90 percent dependent on oil next year, but would be 40 percent dependent on cash from a savings account, which reflected diversification.

[10:05:17 AM](#)

CHAIR SAMUELS announced that Mr. Dickinson will discuss price forecasts from a variety of entities.

MR. DICKINSON directed attention to the chart on a projected slide. He explained that the chart plotted oil price predictions during the last calendar quarter, 2008, by ten analysts which included Citigroup, Merrill Lynch, Deutsche Bank, the federal Energy Information Agency (EIA), and Goldman Sachs. He stated that these price predictions were based on the West Coast and West Texas Intermediate (WTI) daily crude oil prices. He noted that as the actual prices changed, the average annual predictions reflected this same price.

[10:08:32 AM](#)

MR. DICKINSON said that the Department of Revenue (DOR) oil price forecast of \$75 per barrel, which was released in early December, was significantly higher than most other forecasts at that time of \$40 per barrel. He allowed that there was a negative reaction to this forecast. He disclosed that DOR had made the analysis and forecast on October 7, and that a bureaucratic delay resulted in the forecast not being released until December.

MR. DICKINSON pointed out that the EIA does put out a monthly Short-Term Energy Outlook (STEO) which projects prices for the

upcoming year. He commented that the current advanced forecast price of oil is \$51.75 per barrel. He noted that the Short-Term Energy Outlook (STEO) projections are also lagging behind the actual rise and fall of oil prices. He commented that the federal government is also making big decisions based on the energy prices.

[10:11:54 AM](#)

REPRESENTATIVE KELLY asked how far each of the predictors points into the future.

MR. DICKINSON responded that each predictor is looking at calendar year 2009. He explained that since the DOR forecast is for the fiscal year, he used an average of the calendar year predictions.

CHAIR SAMUELS thanked Mr. Dickinson.

DEPARTMENT OF EDUCATION AND EARLY DEVELOPMENT - PUBLIC SCHOOL PERFORMANCE INCENTIVE PROGRAM

[10:13:19 AM](#)

CHAIR SAMUELS announced the next order of business would be a report regarding the Public School Performance Incentive Program.

[10:14:59 AM](#)

EDDY JEANS, Director, School Finance and Facilities Section, Department of Education and Early Development (EED), explained that the Public School Performance Incentive Program was adopted by the legislature three years ago as a pilot program. He said the department has not included the program in its fiscal year 2009 (FY 09) budget and recommends that the program not be continued. Mr. Jeans explained that the program was intended to encourage collaboration at the school level to improve student achievement. He said there has not been a lot of support for the program. For example, during its first year, there were articles in the newspaper claiming the program was pitting teachers against teachers and schools against schools. Mr. Jeans thanked the legislature for the opportunity to conduct the program and said the department does not anticipate the legislature's continued support of it.

[10:17:12 AM](#)

SENATOR HUGGINS observed that many programs initiated by individuals disappear when those individuals are no longer involved.

MR. JEANS, in response to Senator Huggins, confirmed that the program was brought about by former Commissioner Sampson, and he surmised that Commissioner Sampson would support the department's decision to discontinue the program. He added, "There's been a lot of push-back from the district."

[10:17:48 AM](#)

SENATOR HUGGINS said he read about a number of cases in which people said they would not accept the money. He asked how often that actually happened.

MR. JEANS responded that one check was returned to the department in the last two years.

[10:18:18 AM](#)

CAROL COMEAU, Superintendent, Anchorage School District (ASD), in response to Chair Samuels, noted that the Department of Education receives about one quarter of a \$5 billion budget.

CHAIR SAMUELS remarked, "Within 10 years, we're going to have problems ... as production declines." He expressed appreciation that something new got tried. He asked if there are any other ideas being formulated.

MR. JEANS spoke of a three-year funding bill for education passed by the legislature, and noted that the geographic cost differentials will be faced in over a five-year period. He reported that there were increases in the base student allocation of \$100 a year for the next two years after 2009, as well as increases in the intensive needs students category.

[10:20:04 AM](#)

CHAIR SAMUELS warned that "putting money into the same system" currently in place will eventually result in a downward pressure on the department; it will no longer be possible to spend the same amount of money. He clarified that he would like to know if there are any programs currently being considered to stave off the upcoming problems.

MR. JEANS said he does not have any suggestions to increase the state's revenue to support its budget.

[10:21:50 AM](#)

REPRESENTATIVE MEYER offered his understanding that there were three programs implemented under Commissioner Sampson. In addition to the incentive program, there is a mentoring program, which Representative Meyer called "a huge success."

MR. JEANS, in response to Representative Meyer, noted that there is a "coaches' program" where coaching is provided to districts that are not performing well. Both the mentoring and coaches' programs are working well, he said. He noted that Commissioner LeDoux has made internal changes to the Department of Education and Early Development, while the Deputy Commissioner Les Morris will be focusing on the improvement of schools and districts. The department still collects and evaluates student data based on the state assessment, and it provides technical assistance to districts regarding how to use that information to improve student achievement. He opined that the department is heading in the right direction and there will be improvement in public schools.

[10:23:38 AM](#)

MR. JEANS reiterated that the department has not been looking at ways to reduce costs to education. He said consolidation is a concept that even the legislature has discussed numerous times over the years. He noted that Legislative Audit Division conducted a study to see if there would be administrative cost savings by consolidating school districts, and the results of that study showed that the savings would be minimal. He stated, "Unfortunately, Alaska's a very large state with very dispersed population, but we still have an obligation to educate the children wherever they live, and it's extremely expensive."

[10:24:15 AM](#)

SENATOR HUGGINS mentioned the federal stimulus package, and he offered his understanding that "education was one of the categories that was going to be eligible." He asked if the department has made any requests regarding the federal stimulus package that would impact the education community.

MR. JEANS replied that the department is just now getting information about what will be included in the federal stimulus

package. He said, "The big item that has come our direction is funding for ... construction of schools, and we're not sure exactly what our share would be under that, or how that would impact the state."

MR. JEANS, in further response to Senator Huggins, said he does not think deferred maintenance is specified under the federal stimulus package.

[10:25:25 AM](#)

SENATOR HUGGINS, regarding drop-outs, offered his understanding that as soon as a student begins eleventh grade, the clock starts ticking and if the student does not subsequently graduate with his/her class, he/she becomes a drop-out. The governor's association is considering a program in which that clock would start ticking as soon as a student enters ninth grade. He asked what the state's definition of drop-out is.

MR. JEANS said he believes the clock starts ticking when a student enters ninth grade. In response to follow-up questions, he offered his understanding that there are "some adjustments to that calculation," but he said he could not describe them. He said he does not know whether or not special education students are treated differently in that regard. He said he does know that drop-outs are a big issue for the department and Commissioner LeDoux would address the matter forthcoming.

[10:27:19 AM](#)

SENATOR STEDMAN asked Mr. Jeans how a student would be treated if he/she took five years - instead of the four years the rest of his/her classmates took - to graduate.

MR. JEANS responded that that student would be considered a drop-out, but "there is some adjustment that occurs if a student gets their diploma in their fifth year." He said he does not know the exact calculation but could get that information. In response to a follow-up question, he confirmed that graduation rates and drop-out rates are two completely different calculations.

[10:28:47 AM](#)

SENATOR STEDMAN, regarding the stimulus package and the interest the federal government appears to have in the construction of new schools, said in Southeast Alaska, construction of new

schools is not a priority, whereas getting children into school is. He asked where new school construction is warranted around the state versus maintenance.

MR. EDDY reviewed that the department produces two lists: the major maintenance list and the school construction list. The majority of the schools on the construction list exist in "the unorganized areas of the state," and they include old BIA and Molly Hootch schools, which are now getting to the point where they need to be replaced. The only mechanism available to the schools to be replaced is through the state grant program. Conversely, on the major maintenance list there will be a blend of both regional education attendance areas and municipal school districts.

[10:30:52 AM](#)

REPRESENTATIVE KELLY asked Mr. Jeans whether he was surprised at the failure of a program that was [initially] strongly supported by the unions, the National Education Association (NEA), teachers, principals, and superintendents.

MR. JEANS responded that he was not surprised and expressed his belief that the program itself did not fail, but that there was some misunderstanding about what the intent of the program was and how it functioned; therefore, the department elected not to extend the program.

[10:31:48 AM](#)

REPRESENTATIVE KELLY pointed out that movement in a direction to try to measure performance with some elements of competition, and educating and graduating kids, is more important than worrying about hurt feelings. He expressed his disappointment at the failure and urged the department to quit throwing money at problems and to find ways to make needed improvements in the future with the available revenue. He stressed that some initiatives do not have as much to do with money than with complete change, and suggested the funds from this program could be used for additional support for the vouchers program and the [Charter Schools] program. Representative Kelly stated his frustration that programs that will have a major and positive effect do not have the support of the "old traditional crowd."

[10:34:15 AM](#)

CHAIR SAMUELS warned Mr. Jeans about the upcoming revenue problems for the department.

MR. JEANS assured the committee that the department is looking forward to working with the standing committees on education to address some of the issues raised by Representative Kelly.

CHAIR SAMUELS directed Mr. Jeans to work with his staff on the required report to the legislature. He expressed his doubt that the legislature would [fund] the program without the recommendation of the department.

10:35:25 AM

SUPERINTENDENT COMEAU informed the committee that the Public School Performance and Incentive Program was originally supported by superintendents because they liked the idea of collaboration among all of the staff in a school environment. However, in Anchorage each of the schools that received performance incentives were "parent choice" schools of very high socio-economic status. She explained that there was huge growth in the Elementary and Secondary Education Act of 1965 (Title 1) schools, and in other schools, but not quite to the same level. As a result, the situation became very demoralizing to all of the staff. It was recognized that when parents have enough resources to be actively involved in their children's education there is increased student achievement and less parental support was a detriment to schools where parents were unable to provide transportation. Additionally, in rural areas with two or three schools, incentives received by one school because of varying circumstances and not because of the effort on the part of the school, divided the community. She clarified that she was not against incentivizing schools, but there are other ways to do that and expressed her desire to "be part of the discussion."

SUPERINTENDENT COMEAU related that the staff of a charter school that received an incentive had acknowledged that active parental involvement made a huge difference in the ability of its students to attend school regularly and not "move around a lot." In fact, none of the Anchorage schools receiving an incentive had a high mobility rate, not because parents are dissatisfied with the school, but because of where affordable housing is available. She noted that she was glad to hear the discussion on this subject as she was about to present the ASD budget. Contrary to some school districts, the ASD is continuing to gain students and is struggling with its budget that was based on the October count date.

[10:38:44 AM](#)

REPRESENTATIVE DOOGAN asked whether there is historical data that indicates whether the April student head count is significantly different than the October count date.

SUPERINTENDENT COMEAU answered that this is the first time Anchorage's school population in January is higher by far than in October. Historically, due to early graduation and drop outs, the school population declines at the end of the first semester. In response to a further question, she confirmed that at this point in time, her district has 500 more students than in October.

REPRESENTATIVE STEDMAN mentioned that during the legislative session the department will be invited to present information about school enrollment across the state. He opined that there seems like there has been an acceleration in numbers this year.

[10:40:36 AM](#)

SENATOR HUGGINS asked Superintendent Comeau to suggest other ways to incentivize performance.

SUPERINTENDENT COMEAU expressed her belief that money is not the way to incentivize people. She opined that teachers, principals, and superintendents are working very hard to increase student achievement and the graduation rate. The biggest challenge for teachers is finding time to collaborate within their work day. She said that adding time into the work year - perhaps by additional compensated days into the school year, or additional hours to the day for planning, collaboration, training, and professional development - would go far to incentivize and encourage the good work the staff is doing in the school.

[10:42:08 AM](#)

SENATOR HUGGINS asked whether Superintendent Comeau was suggesting increasing staff.

SUPERINTENDENT COMEAU replied no. She reiterated that compensated time could be added to each [current] teacher's day for collaboration, planning, and professional development. Or, additional paid days could be added to the school year to provide for the additional time needed to improve lessons.

SENATOR HUGGINS noted that this model is being practiced in some middle schools in the state. He asked for Superintendent Comeau's thoughts about two head counts during the school year as recommended by the Mat-Su Borough School District.

SUPERINTENDENT COMEAU agreed that if a school's student enrollment goes up there needs to be an opportunity to apply for supplementary funding in February or March. In addition, when intensive-needs students enroll after the count date there needs to be an opportunity to look for additional funding.

[10:44:05 AM](#)

SENATOR HUGGINS asked how the money [for additional or intensive-needs students] can follow the student from school to school as they move.

SUPERINTENDENT COMEAU confirmed that teachers are hired in the fall with a contract for the school year. That is the biggest challenge.

[10:44:38 AM](#)

SENATOR HUGGINS asked whether the migration of rural students into Anchorage schools has noticeably increased.

SUPERINTENDENT COMEAU explained that students come and then go. In January a group [moved to Anchorage] from rural Alaska and many families have come in from California looking for jobs. In addition, there has been an increased military buildup in the Matanuska-Susitna Valley, Fairbanks, and Anchorage.

[10:45:19 AM](#)

SENATOR HUGGINS asked for a description of the ASD mobility rate this year.

SUPERINTENDENT COMEAU said she would provide that information. However, some schools have a very stable student population rate and others, in mostly Title 1 schools and in areas of affordable housing, have a 200-300 percent turnover.

[10:45:59 AM](#)

SENATOR HUGGINS spoke of "performance oriented" students moving from one school to another with a coach. "[Do] we have the right structure to fix that or not?" he asked.

SUPERINTENDENT COMEAU responded that the Alaska School Activities Association (ASAA) governs that when a child's family moves its residence, the child can participate in activities at the new school; however, there is a one-time summer transfer rule and if the student moves again he or she can not participate in activities for eighteen weeks.

[10:47:12 AM](#)

CHAIR SAMUELS referred to a study by the University of Alaska, Anchorage (UAA), Institute of Social and Economic Research (ISER), that indicated 57 percent of the municipal budget was tied to oil [production].

SUPERINTENDENT COMEAU recommended that committee members read the ISER study.

CHAIR SAMUELS stated that [he and] Senator Meyer will write the report to the legislature on this program.

EXECUTIVE SESSION

[10:48:22 AM](#)

REPRESENTATIVE STEDMAN made a motion to move to executive session under Uniform Rule 22 for the purpose of discussing confidential audit reports under AS 24.20.301. There being no objection, the committee went into executive session at 10:48 a.m.

CHAIR SAMUELS invited Josh Applebee to stay for the executive session.

CHAIR SAMUELS called the committee back to order at 10:56 a.m.

FINAL AUDIT - DEPARTMENT OF COMMERCE, COMMUNITY, & ECONOMIC DEVELOPMENT, BOARD OF PUBLIC ACCOUNTANCY - SUNSET

CHAIR SAMUELS announced that the next order of business would be consideration of the final audit for the Department of Commerce, Community, & Economic Development, Board of Public Accountancy - Sunset.

REPRESENTATIVE KELLY inquired as to clarification of the process taken for the closure of an investigative complaint.

10:56:15 AM

PAT DAVIDSON, Legislative Auditor, Legislative Audit Division, Alaska State Legislature, responded that complaints made to the investigations unit of the Division of Corporations, Business, and Professional Licensing (DCBPL) are prioritized using a three-tiered system, determined by the importance of the complaint. Thus, she noted, complaints that affect life or safety, such as those that would affect the Alaska Board of Pharmacy or the Alaska State Medical Board, would have a higher priority for investigation than complaints that affect consumers, which would have a secondary emphasis. Additionally, the licensing board will often initiate complaints that fall under their regulations, and those complaints are generally considered a lesser priority than life or safety and consumer complaints. She added that the DCBPL investigators currently attempt to prioritize their efforts. She opined that the Board of Public Accountancy (BPA) has generally been satisfied with the efforts of the investigative unit. She further opined that the investigator's priority process also works well. However, she noted that in instances of staff turnover that absent a good case management system, new staff does not know where to begin. She suggested that this is the area within investigations that needs improvement.

10:57:58 AM

REPRESENTATIVE KELLY inquired as to whether a procedure exists that requires the BPA to respond to a complainant within a specific time period, regardless of whether it is for a high priority complaint or one of a lesser priority. He further inquired if the BPA would then revisit the matter and grant an extension of time for the investigation.

MS. DAVIDSON responded that she is not aware of the protocol for interaction between the BPA and the Division of Corporations, Business, and Professional Licensing investigators when an initial complaint is made. She added that the purpose of the investigation is to determine whether a licensing action should be taken, and if so, the recommendation is taken to the board. She recalled that the BPA meets about four times a year. She reiterated that she did not have an answer with respect to the turnaround time for the BPA to respond to the complainant since she is not aware of the dialogue between the investigator and

the board. She advised that the process used by the Legislative Audit Division auditor is to review timeframes for how quickly resolution of investigative cases occurs, the length of time it takes to bring the matter to the board, and whether the BPA takes its action in a speedy manner.

10:59:43 AM

REPRESENTATIVE KELLY noted that he did not wish to slow this audit down since it is his understanding that there has been improvement in the delivery of investigation service. He inquired as to whether the investigations unit of the Division of Corporations, Business, and Professional Licensing Division could be required to ensure that all complaints are handled timely, regardless of the level of complaint.

CHAIR SAMUELS inquired as to whether Representative Kelly is offering this suggestion with respect to complaints for all licensing boards or specifically to complaints under the BPA.

REPRESENTATIVE KELLY reiterated that while he did not want to delay action on this sunset review, he suggested that complaints should be handled within a certain timeframe. He said that perhaps a matrix could be developed to provide the BPA an overview of the progress taken on investigative complaints.

11:01:02 AM

CHAIR SAMUELS offered that one option to ensure this happens would be for the Legislative Budget and Audit Committee staff to work to establish a general policy for all sunset audits rather than to amend the statutes. He further noted that the Legislative Budget and Audit Committee could work with legislators who oversee the Department of Commerce, Community, & Economic Development (DCCED) budget in order to help establish parameters on the budget and to ensure the goal that the licensing boards are more responsive.

11:01:31 AM

MS. DAVIDSON said that about seven or eight boards will be coming up for sunset audit reviews during the upcoming legislative session, of which at least five are regulatory boards. She suggested that the Legislative Audit Division could review not only that the investigators are prioritizing the cases, but could also review the aging of complaints to determine how fast the complaint is resolved. She further

offered that in her experience it is not uncommon for a board, such as the Board of Barbers and Hairdressers (BBH), to be less satisfied with the Investigative Unit of the DCBPL than the State Medical Board (SMB) because complaints against the BBH would tend to fall into the lowest category of effort by the investigators and the complaints for the SMB would have a higher priority. She reiterated that with at least five regulatory boards due for sunset audits this year the auditors could review not only the priority of complaints, but could also review aging of ongoing investigations.

11:02:48 AM

REPRESENTATIVE KELLY acknowledged that the additional layer of review would help and could also help legislators better assess the complaint processes for each of the boards.

CHAIR SAMUELS suggested that the Legislative Budget and Audit Committee could work with the House and Senate Labor & Commerce committees (L&C) since all of the sunset bills are ultimately referred to the L&C committees for review. He offered that Ms. Davidson could work with Legislative Budget and Audit Committee staff to draft letters to the respective L&C committee chairs with suggested intent language for them to consider attaching to any sunset bills.

REPRESENTATIVE KELLY responded with his preference for that to happen.

11:03:53 AM

REPRESENTATIVE DOOGAN recalled a recommendation about not filling vacant positions very quickly and he further recalled that several recommendations like that were included in other preliminary sunset audits.

MS. DAVIDSON acknowledged Representative Doogan is correct. She recalled the issue arose when the Legislative Budget and Audit Committee considered an audit for the Suicide Prevention Council (SPC). She further recalled that the Legislative Audit Division had previously recommended more timely appointments to the SPC. She said auditors have recommended statutory changes to reduce some of the requirements for the SPC members. She noted that requirements for the members of other professional boards are not that stringent. She added that the licensing boards generally meet quarterly and preparing for a meeting requires time, effort, and energy on the part of all board members.

[11:05:13 AM](#)

REPRESENTATIVE DOOGAN inquired as to whether this [vacancy] issue is a new problem or if this is an historical problem that has worsened.

MS. DAVIDSON responded that the issue [of vacancies] ebbs and flows. She noted it is not always an issue, but it is not uncommon for the issue to arise. She said the problem is exacerbated in instances of boards and commissions that have more narrowly defined requirements. She further stated that with the BPA it is just a matter of [the appointments] just not being done.

[11:06:02 AM](#)

SENATOR STEDMAN made a motion that the following final audit report be released to the public for response:

Department of Commerce, Community, & Economic Development,
Board of Public Accountancy - Sunset

There being no objection, the motion passed.

OTHER COMMITTEE BUSINESS

[11:06:22 AM](#)

CHAIR SAMUELS asked to add one additional item to the agenda. He explained that a motion was needed to approve a Reimbursable Services Agreement (RSA) to the Department of Natural Resources (DNR) since at the last Legislative Budget and Audit Committee meeting the motion included an RSA to the Alaska Department of Fish & Game (ADF&G), but the committee inadvertently omitted the motion for DNR for the RSA to cover the R.S. 2477 and Navigable Waters.

CHERYL SUTTON, Staff to Representative Ralph Samuels, Alaska State Legislature, clarified that the Legislative Budget and Audit Committee had approved a motion at its last meeting for DNR. However, she noted that the motion did not cover the full amount and this motion would correct the amount of the RSA to the portion allocated to DNR for the RSA.

[11:07:10 AM](#)

SENATOR STEDMAN made a motion that the Chair be authorized to amend the existing contract with the Department of Natural Resources for research and preparation work on R.S. 2477 and navigable waters to an amount not to exceed \$70,000.

There being no objection, the motion passed.

[11:07:32 AM](#)

CHAIR SAMUELS thanked Ms. Sutton for her work over the past legislative session.

SENATOR HUGGINS assumed this was Chair Samuel's last official act as the Legislative Budget and Audit Committee Chair. He thanked Chair Samuels on behalf of the Senate and said Chair Samuels has earned the respect of the legislature and the public. He also offered his personal thanks to Chair Samuels.

CHAIR SAMUELS noted his appreciation for the comments.

[11:08:42 AM](#)

ADJOURNMENT

There being no further business before the committee, the Legislative Budget and Audit Committee meeting was adjourned at 11:08 a.m.