

HOUSE FINANCE COMMITTEE
January 21, 2010
1:33 p.m.

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CALL TO ORDER

Co-Chair Hawker called the House Finance Committee meeting to order at 1:33 p.m.

MEMBERS PRESENT

Representative Mike Hawker, Co-Chair
Representative Bill Stoltze, Co-Chair
Representative Bill Thomas Jr., Vice-Chair
Representative Allan Austerman
Representative Mike Doogan
Representative Anna Fairclough
Representative Neal Foster
Representative Les Gara
Representative Reggie Joule
Representative Mike Kelly
Representative Woodie Salmon

MEMBERS ABSENT

None.

ALSO PRESENT

Representative Bob Buch; Representative David Guttenberg; Pat Galvin, Commissioner, Department of Revenue; Daniel Stickle, Petroleum Economist, Department of Revenue; Dona Keppers, Audit Master, Tax Division, Department of Revenue; Jerry Burnett, Deputy Commissioner, Department of Revenue;

PRESENT VIA TELECONFERENCE

Jennifer Duval, Petroleum Economist, Department of Revenue; Frank Molli, Production Forecasting Consultant;

SUMMARY

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Co-Chair Hawker discussed housekeeping. He reminded the committee that budget overview meetings were meant to foster a productive conversation between the department and the legislature.

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Co-Chair Hawker queried the fiscal standing of the state at the end of FY 2009.

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, began the presentation titled, "Overview of Fall 2009 Revenue Forecast" (copy on file). He informed the committee that FY 2009 had ended with a surplus. He introduced his support staff and described their expertise.

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Co-Chair Hawker asked how long the position of lead economist for the state had been vacant. Commissioner Galvin replied that it has been vacant for a year and a half. He relayed that the department has been searching nationwide to fill the position but that, at the salary being offered for the classification of chief economist, no candidates have applied. Co-Chair Hawker wondered if the position remained unfilled; it could be taken out of the budget. Commissioner Galvin replied that the position was necessary. He added that currently, members of the department were sharing the responsibilities of the position, to the detriment of the state.

Representative Doogan wondered about the positions salary. Commissioner Galvin replied that the position paid \$86,000-\$100,000 per year, depending on the qualifications of the new hire. Thus far, a qualified applicant has yet to apply. The department has pursued a bill to make the position exempt, to allow for a higher salary. He felt that filing the position would require offering a higher wage. Representative Doogan asked how much the wage would need to be increased. Commissioner Galvin answered that it would depend on the level of experience wanted. He thought a salary raise of 50 percent would attract a suitably qualified applicant.

Representative Joule asked if the department had included the salary raise in the budget request.

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Commissioner Galvin replied that legislation would be needed in order to convert the current position into an exempt position, and a fiscal note would accompany the legislation, noting the additional salary.

Co-Chair Stoltze asked about Slide 6, "FY 2010 and FY 2011 Non-Oil Revenue Detail". He asked if mining, insurance, tobacco and motor fuel taxes contributed more to the economy than fisheries taxes.

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DANIEL STICKLE, PETROLEUM ECONOMIST, DEPARTMENT OF REVENUE, cited pages 50 and 51 of the Revenue Sources Book, which shows that a majority of the fisheries revenue was considered restricted. He stated that the slide illustrates the portion of the revenue that the department considers unrestricted.

Co-Chair Stoltze felt that fishing was a primary industry in the state and that the projected revenues should be higher. He felt that the numbers were surprisingly low and thought they could come into play in the further evolution of the Carlson litigation [For most recent case, see State v. Carlson, 191 P. 3v 137 (Alaska 2008)].

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Representative Austerman reminded the committee that the legislature was responsible for determining which taxes would be distributed to municipalities and not placed in the general fund.

Representative Fairclough wondered if centralizing the hiring process would be advantageous to the department in order to fill vacancies. Commissioner Galvin replied centralizing the classification system and salary systems have had both positive and negative effects. One of the negative aspects that the department has experienced with specialized personnel, was a disconnect between what the department could offer, and what the market was seeking.

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Representative Fairclough asked if there had been any candidates that have responded that may have been lost in the system. Commissioner Galvin replied that he was not aware of any. He added that one applicant had met the minimum requirements, but withdrew before an interview. Representative Fairclough asked how much time passed between receiving the application and offering the interview. Commissioner Galvin replied that time had not been the issue.

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Representative Gara asked if fisheries related companies paid a corporate income tax, in addition to the individual fisheries taxes listed. Commissioner Galvin replied yes. He furthered that the department's method of calculating petroleum related income tax could be found on Page 50 of the Revenue Sources Book.

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Representative Gara speculated that positions were not being filled statewide because competitive salaries were not being offered. Commissioner Galvin relayed that the Commissioner of Administration was attempting to address the problem. He stated that a comprehensive statewide salary survey had been conducted and the numbers would be available.

Representative Gara wondered why the department had not approached the union to fill the position. Commissioner Galvin thought the question could be better answered by Commissioner of Administration.

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Representative Doogan understood that \$2 out of every \$3 of fisheries tax revenue were restricted. He requested clarification concerning how much of the fisheries related revenue was unrestricted verses restricted. Commissioner Galvin said that the department would provide a report to the committee that would break down the distribution of the corporate income tax and identify other areas of fisheries revenue.

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Commissioner Galvin reintroduced the presentation titled, "Overview of Fall 2009 Revenue Forecast"(copy on file). He referred to Slide 2, "Outline for Presentation". Co-Chair Hawker interjected that the high-level presentation was intended as a point of reference from which the rest of the session would progress.

Commissioner Galvin continued with the presentation. Slide 4 details "FY 2010 and FY 2011 Total Revenue". Commissioner Galvin said that the department was projecting \$4777.9 million of total unrestricted revenue. Recognized restricted revenue totaled \$7,870.2 million, which results in a total revenue for FY 10 of \$12,648.1 million.

Co-Chair Stoltze asked if permanent fund earnings were restricted. Commissioner Galvin replied that it would depend on whether the funds were realized or unrealized. Realized funds would be placed into the unrestricted earnings reserve. Unrealized gains to the fund would be considered part of the principal and would remain unavailable.

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Representative Austerman asked when the unrealized gains portion would be discussed. He asked what percentage of the projections were unrealized gains. Commissioner Galvin offered to provide the numbers at a later date. Representative Austerman clarified that the numbers in the

presentation were an estimate. Commissioner Galvin explained that the numbers in the presentation were a projection based upon what the investment advisors provided as the expected earnings in the current asset allocation.

Co-Chair Hawker reminded the committee that the presentation was a revenue forecast and, therefore, entirely an estimation.

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Commissioner Galvin informed the committee that the department had 6 months experience in FY 2010, but that the numbers after that were total projections. Fiscal Year 2011 is a complete projection.

Representative Gara asked what the oil revenue total was for FY 2008. Commissioner Galvin replied that according the Revenue Sources Book, Page 88, the unrestricted total for oil revenue was \$10 billion in FY 2008, and 5.2 billion in FY 2009.

Representative Gara asked if the lower number of \$4,167, projected for FY 2010, was a result of a previous decline in oil prices, or a decline in production. Commissioner Galvin replied that it was a combination of both, and an added increase in company expenditures.

Co-Chair Hawker reminded the committee about the challenges associated with the spring revenue forecast. The spring forecast assumed an average price of \$58.29 per barrel of oil. The fall forecast numbers were equated assuming a price of \$67 per barrel. He summarized that the budget, which was on a break even basis in the spring, was expecting a surplus in FY 2010.

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Commissioner Galvin shared that in 2008 the department went from a surplus budget, to a deficit budget, in the course of going from the budget to the supplemental. This year the opposite is expected. Co-Chair Hawker asked if the department has the sense that the oil market has stabilized. Commissioner Galvin replied that the departments economists project, but do not assure, a period of stability. The economic recovery was happening faster than expected, in the oil market in particular, whether the recovery can be sustained remains to be seen.

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Representative Doogan wondered if the hope for economic stability was based on the projected oil price of \$67 per barrel. Commissioner Galvin replied there was a section on

price forecasting in the presentation which would enlighten the committee on the issue. He continued to Slide 5, which estimates an increase of unrestricted revenue to \$5.2 billion in FY 2011. The overall revenue, because of expected reduction in restricted revenue, should be balanced between the total revenues.

Co-Chair Hawker requested to revisit Slide 4. He pointed out that the slide presents the unrestricted federal revenue for FY 2010 and FY 2011 as the same number. He presumed that the totals included the federal stimulus dollars that had been appropriated, and asked for details as to where those funds were being spent.

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JENNIFER DUVAL, PETROLEUM ECONOMIST, DEPARTMENT OF REVENUE, (via teleconference) commented on the methodology used by the department for projecting the federal revenue in the Revenue Sources Book. She said the forecast was under the direction of the Office of Management and Budget (OMB). She explained that the federal revenue number was kept flat in the fall projection due to the inability to give assurances on projections two years into the future. In the spring, as the department gains confidence on the projections, the FY 2011 numbers will be updated.

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Commissioner Galvin continued to slide 6, "FY 2010 and FY 2011 Non-Oil Revenue Detail".

Representative Gara wondered if the mining number on page 6 represented taxes and royalties. Commissioner Galvin replied that the number indicated taxes. Representative Gara asked if there was a substantial royalty number available.

Mr. Stickle explained that the department did receive a small amount of royalties from mining on state land. The number was listed in the "other" field under the "revenue type" section of the slide. He added that the number was relatively small compared to the tax component. Representative Gara asked for the specific numbers. Commissioner Galvin replied that the numbers were detailed in the Revenue Sources Book.

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Commissioner Galvin continued to Slide 8, "10-Year Revenue and Spending". Slide 8 details the assumed fall 2009 revenue and 3 percent budget escalation from FY 2011. He explained that revenue expectations were enough to sustain a flat-line budget that increases with the rate of inflation, and provides a surplus. Little capital spending is built into

the projection, which results in a growth of reserves. At the end of the ten-year projection, the balance of the Constitutional Budget Reserve (CBR) is expected to be \$24 billion. He said that the numbers were a reflection of revenue expectations and current spending levels.

Co-Chair Hawker stated that the numbers were attractive to him. He clarified that the numbers were source book calculated projected revenues, which were a relationship between the calculated result of both future estimated price fluctuations, and future estimated production volumes. Commissioner Galvin agreed. Co-Chair Hawker added that the slide did not consider any proposals that have currently been offered by the legislature or the governor. He stressed that the slide represents appropriation projections and is subject to change.

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Representative Doogan asked if the components contributing to the growth of the CBR, from year to year, were an assumption that surpluses would be deposited in to the CBR in addition to the level of investment income. Commissioner Galvin replied in the affirmative. He believed that there was also an assumption of deposits. He added that he CBR is also a depository for any settlements on tax disputes. Historically, the department's projected CBR balance did not include any expectation of settlement deposits. Representative Doogan clarified that whatever was not spent by the state was deposited into the CBR and earned money on a year-to-year basis through investment. Commissioner Galvin said that was correct.

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Co-Chair Hawker pointed out to the committee that the source book projections for FY 2010 used the current price of \$66.93 per barrel of oil. Commissioner Galvin added that the FY 2011 projection was based on an estimated \$76 per barrel. Co-Chair Hawker stated that the year-to-date average is \$73 per barrel which, if the number maintains, or rises, indicated a successful FY 2010.

DONA KEPPERS, AUDIT MASTER, TAX DIVISION, DEPARTMENT OF REVENUE, introduced her support staff in presenting the high level oil production forecast.

FRANK MOLLI, PRODUCTION FORECASTING CONSULTANT (via teleconference), discussed Slide 10, which details the "Alaskan North Slope (ANS) Production, History and Forecast from 1978-2030". He shared the methodology used to produce the forecast. Production data from each well was gathered from the Alaska Oil and Gas Conservation Commission, which was then applied to a trend analysis for each well. This,

along with discussions with the operators, and their plans of development for future wells, and consideration for public and private information, was summed on a per fill basis to produce the forecast found on the slide. He felt that the forecast was prudent compared to past years. The areas that did not meet the "under development" criteria such as; the Alaska National Wildlife Refuge (ANWAR), the National Petroleum Reserve Alaska (APRA), and the Ugnu Heavy Oil Deposit, are not included on the slide. Not included, but worthy of consideration in the future, is the Umiat field, with an estimated 1 billion barrels in place and the probable recovery of 200 million barrels. He continued to Slide 11, which depicts the detailed representation of the forecast portion only.

Ms. Duval addressed Slide 11 titled, "Forecasted ANS production FY 2010 through 2030". She explained that the gray area on the chart represented the oil forecast for projects currently producing oil. Typically the forecast has been divided into three categories; currently producing, under development, and under evaluation. The myriad of colors on the chart represent what was expected to be produced from new projects. She pointed out to the committee that the off-shores listed in the legend were Ooguruk and Nikitchuck. The bulk of the forecast comes from new projects under development and under evaluation, which would mitigate decline, were they to come online.

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Co-Chair Hawker asked if the new project components correlated to Figure 4-11, on Page 40, of the Revenue Sources Book. Ms. Duval replied that that was correct. Co-Chair Hawker summarized that the production expected in 2013 was under development or under evaluation. Ms. Duval answered in the affirmative. He asked if the layers of the chart included both categories of under evaluation and under development. Ms. Duval said yes. Co-Chair Hawker asked how the projected production was divided between under development and under evaluation. Ms. Duval replied that for the next 10 years 80 percent of new oil is considered in the under development category.

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Representative Gara asked if the projections assumed a gasline. Mr. Molli replied that it did. He added that where the pink section on Slide 11 expands was Point Thompson, and assumed a gas pipeline.

Commissioner Galvin clarified that the gasline was not included as part of the economic projection until FY 2020.

Representative Gara asked about the Point Thompson Oil Development. He wondered if oil could be expected to come from Point Thompson without a gas pipeline. Mr. Molli answered that by 2014 approximately 10,000 barrels per day were anticipated without a gas pipeline.

Co-Chair Hawker asked if the numbers reflected the current anticipated results from the gas cycling development. Mr. Molli reiterated that even without the gas pipeline, 10,000 barrels per day were expected to come from Point Thompson.

Co-Chair Hawker understood the conservative approach that was taken in the projections, specifically the exclusion of ANWR and Ugnu Heavy Oil Development. He wondered what was transpiring in regard to heavy and viscous oil development. Mr. Molli shared that the operators had given no clear plans for the development of the oil. Commissioner Galvin added that the development plans may not have changed for those producers, but that the department had been more critical with specific development expectations in order to include them in the forecast.

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Co-Chair Hawker wondered if the current tax regime has made economically inconvenient for the producers. Commissioner Galvin replied that the question would need to be directed to the specific producers. He added that the companies had given the department no indication that the current tax system had been a problem.

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Representative Austerman asked about the production of oil over the next 20 years, as charted on Slide 11. Ms. Duval replied that by 2030, projections indicated 20,000 barrels produced per day. Representative Austerman asked if there had been discussion with producers of the volume number that would signal the closure of the pipeline.

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Commissioner Galvin stated that the department had focused on the issue of operational capacity of the Trans Alaska Pipeline System (TAPS), primarily because of the impact of property tax evaluation of the asset itself. The asset life is a direct component in assessing the value of the TAPS line. Historically, 300,000 barrels per day has been the operational viability figure. That was based on the construction design and operational ability to flow 200 million barrels per day at its peak. With the strategic realignment of the systems within the TAPS structure, operational viability has been significantly reduced. It was the view of the department that there would be 100,000 to

200,000 barrels produced daily. Additional costs would be expected for operating the pipeline at that level, but it would not affect the operational viability of the pipeline. Representative Austerman felt that knowing the volume number kept the lifetime of the pipeline in perspective.

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Co-Chair Hawker referred to a document "Alaska North Slope (ANS) Production Forecasts for 2015 from Fall Revenue Source Books-2004 to 2009" (copy on file). He expressed concern for the increase of production decline through 2018. Mr. Molli replied that the Point Thompson forecast out to 2022-23, is an under evaluation forecast. Because the department extended the ramp up of Point Thompson out 2 years, from where it was in 2007, combined with projects moving from under evaluation to under development, could be why the 2018 projections show a drop in production. Co-Chair Hawker expressed anxiety that policy decisions were being made that were accelerating production decline. Commissioner Galvin responded that the department had worked to create projections that were reasonable and dependable. He reiterated that 80 percent of the numbers projected fall under the category of under development and are less speculative. He said that while the number was going down; the confidence level was going up.

Co-Chair Hawker asked if the department believed that the 2004-2009 numbers were inconsequential in the projections. Commissioner Galvin said no. He added that broad factors were used when projecting the production expectations. Changes in regard to land access, permitting, technological advances and oil price expectations were drivers of spending and production expectations. He felt that policy decisions should be scrutinized in the broad sense.

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Co-Chair Hawker felt that the current price of oil argued the opposite. He said that the factors would be examined closely and the results would be quantified.

Vice-Chair Thomas asked why there were no projected increases for tax credits in the Fall Revenue Source Book. Commissioner Galvin relayed that the information could be found on page 34 of the source book. He recommended Figure 4-7, as a useful layout of the way the production tax operates. He added that any legislation would include a fiscal note that would reflect the projected impact to the numbers.

Co-Chair Hawker furthered that the tax credits were one element of the tax structure. In making investment decisions it was best to examine the total taken by the government.

Commissioner Galvin added that profitability was also a factor.

Vice-Chair Thomas asked if the tax credit applicants were kept confidential. Commissioner Galvin replied that individual company tax records were confidential. Representative Thomas wondered what formula was used in determining the tax credits. Commissioner Galvin responded that the formula taxed 20 percent of the company's capital expenditures.

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Representative Gara recalled that prior to the Petroleum Production Tax (PPT), new oil on the North Slope outside of; Alpine, Prudhoe Bay, Northstar and Kuparuk, paid zero percent production tax. Commissioner Galvin replied that he was not prepared to respond to the generalization.

Representative Gara directed attention to page 38 of the Revenue Sources Book. He stated that a lower oil tax had not attracted more production in the past. He highlighted that in 2000, over 1 million barrels were produced per day. Between 2000 and 2006, production dropped by 300,000 barrels per day. He asserted that reducing the oil tax would not guarantee more oil production.

Representative Austerman referred to the chart on Page 11 of the revenue forecast. He asked if oil exploration and production worldwide had been considered when creating the chart. Commissioner Galvin responded that the potential production in the rest of the world would drive the price forecasting. Price expectation would then play a role at the individual company level in terms of what could be spent going forward. Representative Austerman thought that the less oil available in the world would drive companies to drill for more oil within the state. Mr. Molli added that the price of oil would steer the amount of investment that companies would make. Predicting the price numbers was the challenge.

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Commissioner Galvin remarked that oil production in Alaska was not driven by the need to fill a supply obligation. It is driven by economics and the profitability of producing additional oil. If the price supports the investment, that investment will result in the production level.

Co-Chair Hawker reminded the committee that, although the conversation could continue perpetually, time was of the essence.

Commissioner Galvin continued to Slide 12 of the revenue forecast titled, "Production Decline":

- FY 1988: production peak-2.01 million barrels per day (bpd).
- FY 2009: production-693,000 bpd, a 66 percent decline since peak.
- FY 1988 to date: production decline rate-4.9 percent per year, on average.
- Forecast production decline rate-3.6 percent per year, on average, through FY 2030.

Ms. Keppers explained the process used to determine price. The oil price forecast is compiled from several sources, including a one-day forecasting session with attendees from various state agencies, as well as industry experts. In the session, factors that influence price, such as; supply and demand, the economy, geopolitics, the market, and other factors are considered. Attendees are asked their West Texas Intermediate (WTI) projections and assumptions. The assumptions are logged and compiled. Commissioner Galvin clarified that, historically, Alaska has used WTI as the benchmark for evaluating the price of oil.

Co-Chair Hawker added that the WTI is used because there is not an open, broad market in ANS sales.

Commissioner Galvin explained that the WTI was used as a middle ground, and the ANS prices fluctuate around that, depending on different factors on the West Coast. Generally, \$2.50 was deducted from WTI to come up with the price for ANS oil. Recently, ANS has sold closer to WTI, occasionally at a premium over WTI. Revenue to the state would be derived from the ANS price.

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Ms. Keppers continued to Slide 15, which is a graph of the available WTI price forecasts. She explained that the first variable in price forecasting process was the addition of the numbers from the averaged results of the compiled assumptions of the attendees. The numbers were then compared to available industry expert forecasts, such as; the Energy Information Administration (EIA), The Wall Street Journal, Bloomberg, The New York Mercantile Exchange (NYMEX), and other industry analysts.

Commissioner Galvin interjected that the EIA, the federal government's official forecast, was optimistically charted. The red NYMEX line indicated what the marketplace was projecting into the future.

Co-Chair Hawker added that the NYMEX line was what companies were willing to pay for a futures contract, and anticipated money made on the contract.

Commissioner Galvin explained that the blue line shows the average view of the experts.

Ms. Keppers directed attention to Slide 16, which is a table depicting WTI and ANS for the fiscal years from 2009 through 2015. The numbers for FY 2009 are actual, and the FY 2010 numbers include five months of actual data. The FY 2010 forecast is eight dollars higher than was predicted in the spring of 2009, while FY 2015 is five dollars higher, attributable to a recovery in the economy and oil prices.

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Co-Chair Hawker believed that 2011 was most relevant. He noted that the stability of the price of oil would continue to be a topic of discussion.

Commissioner Galvin relayed that the department no longer attempts derive its own long-term price. The main focus was to establish solid, short term projections, drawing from the expertise with-in the department, and with an escalation rate based on inflation.

Mr. Stickle discussed the lease expenditures detailed on page 18. He stated that lease expenditures became important to the department with the passage of PPT and Alaska's Clear and Equitable Share (ACES), because of the move from a gross value tax to a net value tax, which allows companies to deduct capital and operating expenditures when determining their tax liability.

Co-Chair Hawker asked if the Economic Limit Factor (ELF) was a proxy for net profitability. Commissioner Galvin said yes. He furthered that like all proxies, it was not consistently accurate. Co-Chair Hawker interjected that the state was on an aggregate system that was a proxy for net. Commissioner Galvin expounded that the state was at a disadvantage moving out of the ELF system due to a lack of data to evaluate the accuracy of the system as a proxy. From PPT moving forward, there was a significant amount of missing information, resulting in incomplete equations. With the advent of the net based tax, the spending levels and spending experience of companies has become clearer, which gives the department a better indication of the fluctuations that may exist. He communicated that the vision into the past is imprecise. He spoke of a component of PPT called the Tie Credit Program, where a producer looking at forward spending could gain additional credits based upon past expenditures for the previous five years. That had motivated producers to provide documentation of spending patterns over the past five years.

This has provided a window to a period of time with regard to capital expenditures. The department does not have the same information with regard to operating expenditures.

Mr. Stickle continued. He shared that companies report operating and capital expenditures to the department each month. An annual information form is received by the department monthly from the companies, and is the source of the historical data for FY 2007 through FY 2009. He continued onto Slide 18, which is a chart detailing the lease expenditure costs. He said the forecast was based on projected earning information from the companies, based on current conditions. The department receives unit budgets from the companies going out five to six years, which is the same information the companies use internally and provide to partners.

Representative Fairclough asked if all the regulations had been finalized regarding the accounting of lease expenditures, and, had a standardized format been resolved within the industry. Commissioner Galvin replied that the regulations for lease expenditures were finalized and would be applied retroactively. The statutory changes in ACES resulted in a series of regulation packages, two of which remain outstanding; how the unexpected interruption of service is defined and transportation expenditures. The transportation expenditures will be released in conjunction with Alaska Gasline Inducement Act (AGIA) related open season regulations.

Representative Fairclough asked if the department was confident that the companies would comply with the regulations. Commissioner Galvin said that the industry had given the indication that compliance was a reasonable expectation.

Representative Fairclough asked for a percentage number of money exchanging hands in regards to acceptable expenditures. Commissioner Galvin replied that the department would get back to the committee with the numbers.

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Representative Fairclough reiterated the desire for specific percentage numbers. She wondered if there were outstanding issues with producers whether to deduct or to not deduct, and if the issue would impact the forecast presented by the department. Commissioner Galvin reiterated that he would provide the numbers as soon as possible.

Representative Austerman asked if the department audited the reports submitted by the companies. Ms. Keppers replied yes. Commissioner Galvin added that the timeframe for auditing is

four years between initial submission and when the auditing occurs.

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Co-Chair Hawker wondered why an audit master was acting as the state's chief economist when there was a backlog of audits awaiting completion.

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Commissioner Galvin said that at this time, audits had begun for the first year of PPT, which when completed would provide a clearer picture.

Representative Fairclough asked what level of confidence the producers had for expenditures allowed for deductible when projecting their return on investments. Commissioner Galvin thought the question would be best directed to the producers.

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Mr. Stickle continued to Slide 19, which is a graph detailing historical lease expenditures, for the North Slope, for FY 2007 through 2009, and the forecast for FY 2010 and 2011. The numbers are based on communications with the companies. Operating expenditures were expected to remain steady at 2 billion per year; Capital spending has increased yearly since 2007, and was expected to increase from 2.2 billion in FY 2009 to 2.5 billion FY 2010, and 2.9 billion in FY 2011. Companies have forecasted both decline and increase in capital spending. Decline in capital spending could be offset by new companies coming into the state. The reason for increased spending was the development of new fields including; Ooguruk, Nikitchuk, Point Thompson, and Alpine.

Co-Chair Hawker asked how companies distinguished between a capital expenditure and an operational expenditure. Mr. Stickle replied that the expenditures were defined in the ACES statutes. Co-Chair Hawker asked how the department would direct a company accountant to classify costs. Mr. Stickle replied that he would refer the company to the statute. Commissioner Galvin added that another department member could provide a more elaborate answer upon request.

Representative Doogan asked if it was possible to obtain operating expenditure and capital expenditure numbers for the past ten years. Commissioner Galvin said that a capital expenditure history was possible, because of the Tie Credit reports. Definitive operational expenditure histories were unavailable.

Representative Doogan wondered when, and how, a quantifiable benefit to the state would be expected as a result to the capital tax credits for the oil companies, Commissioner Galvin replied that the oil tax discussion raises the question of investment decision making. The department has struggled with a lack of transparency regarding oil company economic decision making. The department can examine whether or not the practices that companies engage in are satisfactory to DOR. Increased availability of cost, production, and price data could allow the department to replicate the economic drivers of the company decision making to a greater extent.

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Co-Chair Hawker stated that the master auditor had the ability to compel the oil companies to open their financial books. He said that access was available to all the necessary information to pursue audits. He thought that what the department needed was to learn the business decision making process that drives the companies.

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Commissioner Galvin agreed. He said that the department needed more insight into the drivers of investment decisions and how they relate to the economics. The extent to which companies should make their business decisions making known, is debatable. Co-Chair Hawker clarified that the department wanted to know what makes an investment alternative to one company competitive with other investments across the world. Commissioner Galvin disagreed. He stressed that what the governor had asked for, in response to a call for the drop in the overall tax rate, was an indication from the companies on how the change in the cash flow, associated with a particular investment, was going to alter the investment decisions. He argued that he could not respond to what the result of a particular change in the tax law would be, without the decision making insight.

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Representative Doogan said that the insight was important because the administration would be proposing greater tax credits. He thought that it would be useful to know how well the credits were working before expanding them. He felt that it would be difficult to determine how the legislature should proceed with the absence of information. He hoped that the department would be better prepared when coming before the committee in the future.

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Commissioner Galvin responded that when a bill is presented to the committee pertaining to the administrations recommendations, the information needed to justify the requests would be presented. He recognized that, in order to rationalize a tax credit, the department would need to provide more information.

Representative Gara wondered how the 30 percent tax credit proposal was prepared without the financial documentation and information. Commissioner Galvin stated that the information was obtainable but not immediately available. He believed that the overview presentation should not require the specific information.

Representative Gara thought that the tax credit rate should be established when the numbers are definite. Commissioner Galvin explained the rationale used in the governor's recommendations were forthcoming. He furthered that fairness was an issue; the current system treats some companies different than others. He recognized that a full discussion would be necessary in the future about the tax credits.

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Commissioner Galvin discussed Slide 20, which details lease expenditures per barrel.

JERRY BURNETT, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, discussed Slide 22, which charts fund balances and allocations. The first chart is the general fund and other non-segregated investments. The investment objective is of moderate risk and has a short to intermediate investment horizon. The most current audited cash balance available was from November 30, 2009. Co-Chair Hawker interjected that once the department has an opportunity to update the balance, the committee will receive the information. Mr. Burnett explained that daily balances were available to the department, but were unaudited. The General Fund, which includes the Statutory Budget Reserve Fund, the Forward Funding for Education, and the tax credit account has a dynamic balance of \$6.3 billion, and does not reflect obligations or receivables to the account. Co-Chair Hawker added that it was a floating bank account. The second chart shows the main account of the CBR, and reflects a balance of \$4 billion dollars as of November 30, 2009. The unrestricted General Fund surplus from FY 2009 was deposited into the CBR. The third chart details the CBR sub fund, which is larger than the main account, and has a balance of \$4.38 billion. The account will have unrealized losses until it rises to \$4.67 billion. Co-Chair Hawker asked how the accounts were affected by the volatile oil prices of the past. Mr. Burnett replied that as of February 2009, there was a loss of \$1.5 billion. That number is down by \$200 million and is expected to improve over the next five years.

He pointed out an error in the third chart. International Equity should be at 20 percent and not 44 percent. Also, within the Fixed Income there is a one percent allocation to emerging market data. Mr. Burnett stated that the CBR sub fund was the state's most liquid account. The international and domestic equity are comprised of index funds, which are exchange traded, and could be brought out at their market value at any time.

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Mr. Burnett continued to explain that over the past two years the fixed income accounts have not always been liquid.

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Mr. Burnett moved onto Slide 23, "Fund Balances and Allocations". The slide contains two pie charts detailing the Public Employees Retirement System (PERS) and the Teachers Retirement System (TRS). The funds are dynamic. Money is put in by employers and taken out for benefits on a regular basis. Recovery from lows seen in 2008 were visible, but were not yet back up to where they were in 2007. He reminded the committee that the numbers on the chart were a representation of the money under management and the cash account balances. The final slide contains a pie chart detailing the Alaska Permanent Fund Corporation balance. The funds are not broken down into the Earnings Reserve Account and the Principal Account. The numbers are expected to increase as the market moves forward.

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Co-Chair Hawker mentioned articles recently published concerning the Permanent Fund. He expressed concern that Earnings Reserve Account balance would be too low to pay out the fully calculated dividend in October 2010. Commissioner Galvin replied that it was determinate on the market activity and investment returns within the next six months.

Co-Chair Hawker asked if an endowment style of management had been adopted, would the issue exist. Commissioner Galvin replied that if another methodology had been employed, the problem would not exist.

Representative Austerman clarified that new audited numbers of the account balances were available. Mr. Burnett replied that new number were available for most of the accounts. Representative Austerman queried when the next set of audited numbers would be released. Mr. Burnett answered they would be available in February.

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He added that the General Fund and CBR numbers could be given easily, but that the other numbers would take some time.

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ADJOURNMENT

[3:51:23 PM](#)

The meeting was adjourned at 3:51 PM.