

SENATE FINANCE COMMITTEE
February 5, 2009
9:02 a.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Johnny Ellis
Senator Kim Elton
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Pat Galvin, Commissioner, Department of Revenue; Jerry Burnett, Deputy Commissioner, Division of Treasury, Department of Revenue.

PRESENT VIA TELECONFERENCE

Cheryl L. Nienhuis, Acting Chief Economist, Department of Revenue; Dudley Platt, Consultant, Department of Revenue.

SUMMARY

^Presentation: Revenue Forecast & January 2009 Update

OVERVIEW OF FALL 2008 REVENUE FORECAST & JANUARY 2009 UPDATE

Co-Chair Stedman reported that the updated FY09 revenue projections had been recently released and he wanted the committee to be aware of changes.

PAT GALVIN, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the overview of the revenue forecasting process. He emphasized the importance of understanding forecasting given the volatility of oil prices.

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CHERYL L. NIENHUIS, ACTING CHIEF ECONOMIST, DEPARTMENT OF REVENUE (testified via teleconference), provided a PowerPoint presentation, "Overview of Fall 2008 Revenue Forecast & January 2009 Update" (Copy on File).

Ms. Nienhuis explained that there are three variables considered in forecasting both royalty and production tax:

- Production levels,
- Price, and
- Costs, which can also be seen as investment.

Ms. Nienhuis added that up until the passage of the Petroleum Production Tax (PPT), production and price were the only variables that had to be considered. The net profits tax passed with PPT under the Alaska's Clear and Equitable Share (ACES) required forecasting operating costs as well as the level of potential investment.

Ms. Nienhuis pointed out that the variables interact on several levels, and all the variables must be considered in production tax and royalty forecasts. The economic fundamentals of supply and demand affects price, and price has a relationship to both supply and demand. Price also affects production; if price is high, production might go up, because price drives investment decisions, which also drives production levels. Price also affects costs and investments. If the price is high, there will be more investment and higher costs. The price of oil drives up the cost of producing oil.

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Ms. Nienhuis addressed a graph on Slide 5, "ANS Production, History and Forecast" illustrating the history of Alaska North Slope (ANS) production and the contribution of various oil fields. She highlighted that Alaska is in a period of declining oil production. The peak of two million barrels per day was reached in the late 1980s, followed by a rapid decline. The forecast is for a slightly lesser decline and includes a number of lesser fields.

Co-Chair Stedman asked if the oil fields depicted on the graph showing an early spike and rapid tapering were reflective of basins globally.

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DUDLEY PLATT, CONSULTANT, DEPARTMENT OF REVENUE (testified via teleconference), answered that the trend of a peak followed by a steep decline is typical to the extent that there is not often a lot of surplus capacity to produce, as experienced in the Organization of Petroleum Exporting

Countries (OPEC). The trend is irreversible. He believed that ANS production had turned a corner.

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Co-Chair Stedman asked for an explanation of production graphs.

Mr. Platt replied that large alpine fields are complex. A great deal of science and engineering is used to get the most oil out of the ground. The usual extraction expectation is 30 percent. Enhancing techniques will enable ANS operators to get two-thirds out of the ground, leaving another third. He listed methods that can be used to recover more oil, including admissible injection projects and re-injecting carbon dioxide. One challenge is water in the oil. Water is a by-product of producing the oil; dealing with water is expensive.

Mr. Platt described production from other basins with similar trends from peaks to plateaus and then declining production.

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Co-Chair Stedman asked if industry wanting to maximize production as quickly as possible shaped the trend. Mr. Platt replied in the affirmative.

Senator Huggins asked about Point Thompson production. Mr. Platt answered that the issue had been sensitive. He forecasts for purposes of cash flow. He does not forecast for anything that does not exist and he tries to get the timing right. He does not want to suggest that something is going to happen sooner than it realistically will happen.

Mr. Platt explained that Point Thompson can be developed two ways. One is a gas cycling project, requiring compressors to overcome high pressure as well as building a pipeline for the liquids. The expense would be high. The North Slope gas commercialization issues resulted in a second alternative, producing some of the gas first. Exxon Mobile Corporation has proposed infrastructure in order to produce 200 million cf/d of liquid condensate for a \$1.3 billion capital investment for 2014. It is the job of a production forecaster to discern the right course of action.

Mr. Platt emphasized that he assumes a major gas sale-driven project, ten years down the road.

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Co-Chair Stedman asked how Point Thompson would look on the chart viewed from the standpoint of a decade earlier. Mr.

Platt conjectured that the project would be seven or eight years out. Co-Chair Stedman thought it would be producing revenue.

Commissioner Galvin added that the graph shows the layering of multiple fields beginning at different times. He called attention to the width of the bands depicting production.

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Senator Elton asked if production in out-years were predicated on lower shipping costs. Mr. Platt replied that the forecast for Point Thompson was based on a scenario that more closely resembles a major gas project. The question is where the gas would come from. There is gas in other fields on the North Slope other than Prudhoe Bay. Prudhoe Bay will be needed. There will be less oil production if gas were taken from Prudhoe Bay now at the rate of 4.5 bcf/d. Companies are mitigating the lower gas production by pumping additional water into the gas cap to keep pressure up. Pressure keeps oil production going; lower pressure ultimately means lower production. The Alaska Oil and Gas Conservation Commission (AOGCC) has been tasked with solving the problem.

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Co-Chair Stedman asked if it were reasonable to expect Prudhoe Bay and other oil fields to produce two million barrels per day. Commissioner Galvin answered that it was not physically possible to produce that much; the time has passed. The question is whether smaller fields will be cost effective.

Senator Thomas asked if heavy oil were considered in the chart. Mr. Platt answered that there is a lot of opportunity at Oooguruk, where BP and ConocoPhillips are testing new technologies. The projections do not include oil from Oooguruk. West Sak is producing about 16,000 barrels per day and has been an underperformer. ConocoPhillips is trying to produce more oil out of West Sak, which is a challenging project. He delayed West Sak heavy oil production in the forecast. He thought that out of the 5 to 15 billion barrels of West Sak oil in place, only 400 million barrels have been recovered, leaving a lot of opportunity.

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Commissioner Galvin agreed that there is potential but technical hurdles have to be overcome before including the resource in the forecast.

Senator Thomas asked whether the state would want to encourage the development of the needed technology.

Commissioner Galvin replied that the current tax structure encourages heavy oil development.

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Ms. Nienhuis continued with a graph on Slide 6, "Forecasted ANS Production, FY 2009 to 2030," showing oil from currently producing projects and oil expected from new projects. She agreed that the net profit tax encourages investment, which increases production several years before the oil comes on line. The slide highlights the fields coming on-line.

Ms. Nienhuis turned to the second of the forecast variables, price. In order to forecast price, an oil price "Delphi session" is held where stakeholders meet with experts in the field and discuss variables approximately twice each year. The timeline, depicted on slides 8 and 9, is a process that takes several months.

Ms. Nienhuis detailed the timeline for developing a price forecast. A Delphi session was held in October of 2008. Next, final FY08 revenues were compiled and reviewed. At the end of October, the production forecast was finalized. On November 6, the fall forecast was finalized, and on November 10, the cost forecast was finalized. Cost forecasting was new for the group; it is done by reviewing plans of development, looking at global costs, looking at data submitted at monthly information forums, and asking companies for their best guess of upcoming expenses. Throughout the following month, a number of things occurred to finalize the forecasts. Then a fiscal model was created, which takes the large forecasting model and cycles through the Department of Revenue (DOR), the Treasury division, the Alaska Permanent Fund Corporation (APFC), and the Office of Management and Budget (OMB). The fiscal model incorporates revenue forecast variables for the years covered. The various agencies work with the model and contribute input.

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Co-Chair Stedman asked if anything was different in the process this year. Ms. Nienhuis replied that there more people were invited to the fall forecast price session, including Legislative Finance, the University, the governor's office, and the Department of Natural Resources (DNR). The department wanted more people with a stake in the forecast.

Co-Chair Stedman asked who attended from OMB. Ms. Nienhuis replied that John Boucher participated.

Co-Chair Stedman asked why the department did not use published reports and outside experts that forecast

regularly. He wondered how to keep politics out of the process.

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Commissioner Galvin did not think the participants listed would be considered part of a political process. He explained that the method used has been in place at DOR for ten years and is based on a process that draws from a variety of views. The collective input provides a broader perspective. The Delphi system has been the primary method used for the forecasts.

Commissioner Galvin stated that the department was uncomfortable with the Delphi results the previous year, so they ended up blending in other input. The department's intent was to be timely. He assured the committee that there was no political motivation to the process.

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Senator Elton agreed that the issue of timeliness was important. He thought other oil price forecasters are more flexible and came up with numbers faster. He wondered why the state did not take a blend of other well-known forecasts. Commissioner Galvin suggested that the presentation would clarify the question. He stated that the lag is related to the established budgeting process. The department is trying to address the issue by providing interim revenue forecasts during the legislative session. Typically, volatility is relatively minimal, making two forecasts adequate for the budgetary process. This year volatility renders two forecasts inadequate. The department is responding by using interim steps to augment the process.

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Senator Elton opined that the state could get the same results faster using the International Energy Agency (IEA) [Energy Information Administration (EIA)]. Commissioner Galvin replied that the process was not the problem. It takes time to get a revenue number from a price. Once the price is settled, there is still a lengthy process to get the revenue forecast number. He believed the department's process of doing an independent analysis was appropriate and reasonably successful. He did not want to be subject to the biases of other forecasting mechanisms.

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Co-Chair Stedman asked what the price was on October 7, 2008.

Ms. Nienhuis finished the forecasting timeline (Slide 9):

- Revenue Forecast Summary to OMB for Budget Development (11/14)
- Prepare Narrative and Tables for RSB [Revenue Sourcebook] (First Draft 11/18)
- Internal Review, Revisit Models, RSB to Printer (Final Draft 12/8)
- Fall 2008 Forecast Released (12/9)
- Governor's Budget Released (12/15)
- Updated Revenue Forecast & Budget Released for FY 2009 (2/2)

Ms. Nienhuis turned to Slide 10 and explained the Delphi session in more detail:

- Modified "Delphi" technique
- Oct 7, 2008: Prices averaging \$92.85
- Expanded Invitee List: 50 Invitees, 29 participants from DOR, DNR, DOL, OMB, University, Legislative Finance, Legislature, outside participants
- Presentations: Fundamentals (supply & demand), geopolitics, financial markets, analyst expectations, etc.
- 28 forecasts received; Delphi forecast is the "median" forecast of the participants

Ms. Nienhuis pointed out that adding one more forecast would have little impact on the whole. She emphasized that the Delphi technique had been used frequently in the past.

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Co-Chair Stedman asked for the numerics for November 12 and 14. Ms. Nienhuis said the Bloomberg price for November 13 was \$58.24. She pointed out that the price was settled on November 6 as \$60.77.

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Senator Thomas asked what the price was when the governor's budget was released on December 15. Co-Chair Stedman asked for prices for various points on the timeline. Ms. Nienhuis provided the numbers:

- November 14: \$57.04
- December 9: \$42.07
- December 15: \$44.51
- February 2: \$40.08

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Ms. Nienhuis explained that significant time was spent looking at other forecasts towards the end of the process, including forecasts from the EIA, IEA, and the analyst average available through Bloomberg. Slide 11 demonstrates the price forecasts available for the period of July 2008 through June 2010. Through the entire period, Goldman Sachs was around \$110 to \$125; the EIA was higher than that; Merrill Lynch saw the price going down; and the New York Mercantile Exchange (NYMEX), which is updated daily, showed prices coming down and leveling off and then slowly climbing.

Ms. Nienhuis turned to Slide 12, "Oil Price Volatility: 80% decline in 5 months: Historical ANS and WTI [West Texas Intermediate] Crude Prices, May 1986 through December 2008." She pointed out that by the time of the fall 2008 Revenue Sources Book update, the price had not come down to the range it went to in December and January. There was huge decline in just five months.

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Ms. Nienhuis described Slide 13, "Oil Price Volatility: Two of the Most Volatile Years in History." The economic research group looked at about thirty years of prices and did a measure of volatility. The analysis demonstrated that 1991 and 2008 were the most volatile years. In 1991, there was a huge price drop with the first Gulf war, then a leveling out. In 2008 there was not the same level of volatility, but the year started out relatively calm.

Ms. Nienhuis turned to Slide 14, "Price Forecasts as of 11/6/2008," the date the price forecast was finalized. The graph shows how the EIA, NYMEX, Analyst Median, Goldman Sachs, Merrill Lynch, and DOR compare in their forecasts.

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Commissioner Galvin pointed out that the graph reflects the available forecasts on November 6, the expectations of those following the market. The department was significantly lower than other forecasts on that day. The revenue forecast in comparison was higher than DOR's estimate.

Ms. Nienhuis discussed Slide 15, which shows DOR's forecast as a blend. One forecast incorporated was a low scenario prepared in fall 2007. Slide 16 depicts what DOR started with and ended up with. The Delphi median was consistently in the \$90 per barrel range in the last three quarters and projected into 2010 in the same range. The department was uncomfortable with the number as it did not seem realistic. The official fall 2008 forecast was obtained by adding the

NYMEX, EIA, and the DOR fall 2007 low scenario forecasts to the Delphi meridian.

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Ms. Nienhuis explained that Slide 17, "Fall 2008 DOR Oil Price Forecast," shows the ANS forecast in nominal and real dollars. She revisited the idea that forecasting often is advantageous, illustrated by Slide 18, which shows that the analysts' forecasts follow price. When the forecast was made influenced how much the forecast was. Slide 19 depicts the DOR fall 2008 forecast in the low \$60 range. Slide 20 shows recent forecasts, with DOR right in the middle.

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Ms. Nienhuis described Slide 21, "Updated FY 2009 Oil Price Forecast." The forecast was assembled January 20, based on MYMEX prices. The average includes the high prices of the first quarter. The FY09 average for ANS is \$63.28.

Ms. Nienhuis moved from the price forecast to the cost forecast for oil and gas revenue, which is new since PPT. There was not a lot of data to base the price forecast on. She described the transition investment credit, which provided for companies taking a certain percentage of their costs leading up to the PPT as a credit.

Ms. Nienhuis admitted the department was still learning how to forecast costs.

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Ms. Nienhuis discussed Slide 23, which shows the lease expenditures as projected in the fall forecast. She has asked for adjusted expenditure forecasts from the companies investing on the North Slope; those will be incorporated in future. Companies are cutting back because of low oil prices. Operating expenditures are relatively flat; capital expenditures bend as costs are expected to be high. There appears to be a one to two year lag, so capital expenditures may come down. She emphasized that capital expenditures lead up to production and are not necessarily in line with production. The figure includes future production.

Ms. Nienhuis turned to Slide 24 showing the lease expenditures per barrel, separated by operating (OPEX) and capital expenditures (CAPEX). Capital spent per barrel is a future projection.

Co-Chair Stedman asked about a 50 percent delay in CAPEX. He wanted the date the CAPEX numbers were solidified and elaboration on how the changing market conditions affect them.

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Commissioner Galvin explained that the figures are forecasts for actual costs. When the figures are built into the revenue forecast, the issue of allowable capital credits arises. Fifty percent of capital credits are allowable in the year they accrue and fifty percent have to lag a year. The numbers on Slide 24 do not reflect the lag but are projections for the actual expenditures. He referred to Slide 8, the schedule for developing the fall forecast. The numbers reflect information available at the time. Companies have indicated expectations of reduced spending, but there are not formal numbers. Various tools are used to estimate expenditure levels. The interim forecast looks at price as the primary variable for updating the numbers. The other variables will not change significantly.

Co-Chair Stedman expressed concern regarding the delay of \$1.2 billion in FY10. He asked how the flow of the net would be affected. Commissioner Galvin answered that the structural lag in the application of the credits to the revenue stream is already incorporated into the revenue forecast.

Co-Chair Stedman talked about effects of the price falling rapidly.

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Commissioner Galvin stated that the revenue number incorporates the structural lag in the application of the credit to the revenue forecast. The bottom line number is buffered from changes in expenditure levels in any particular year. The margin of difference between what is forecasted and what is experienced could be half the amount in any particular year. The justification for making the lag part of the process is to assist in the rolling revenue forecast process.

Co-Chair Stedman thought the fifty percent lag was good policy.

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Ms. Nienhuis continued with Slide 25, the capital portion of Slide 24, showing the history for capital lease expenditures and illustrating that investment credits help. High price may help as well. Companies are reporting projected costs that are probably conservative. The costs could come down.

Ms. Nienhuis turned to Slide 26, FY09 total revenue. There was a \$1.2 billion difference from the fall forecast. Most of the amount is attributable to price. The slide shows

unrestricted revenue, or that which is available generally for legislative appropriation, and restricted revenue. The revenue is restricted from DOR's point of view. Slide 27, "Restricted vs. Unrestricted Revenues":

- All revenue is classified as either "Restricted" or "Unrestricted."
- All amounts in the presentation are Unrestricted Revenue only.
- Restricted = Use of this revenue is restricted by constitution, state or federal law, trust or debt restrictions, or customary practice. This means the legislation normally appropriates money back to fund programs.
- Unrestricted = Revenue available for general appropriation. This is the amount typically discussed in budget context.

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Co-Chair Stedman returned to Slide 26 and asked why the investment earnings number is so large. Commissioner Galvin explained the number represented unrealized losses to the value of the permanent fund and the constitutional budget reserve (CBR).

Co-Chair Hoffman asked the actual unrealized losses at the end of December.

JERRY BURNETT, DEPUTY COMMISSIONER, DIVISION OF TREASURY, DEPARTMENT OF REVENUE, answered that he could get the information.

Co-Chair Hoffman asked if the department anticipated positive or negative earnings for the last six months. Mr. Burnett responded that there was no reason to expect negative earnings for the next six months. However, negative earnings were not expected for the year. Commissioner Galvin offered to provide a breakdown of the numbers.

Co-Chair Stedman asked for the December 31, 2008 and January 31, 2009 balances of realized and unrealized gains and losses on the permanent fund and the CBR balances with sub-account breakdowns.

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Commissioner Galvin clarified that the question was based on the FY09 forecast of the investment loss, and how much was based on actuals compared to projections.

Co-Chair Stedman added and that the committee wanted figures as they were compiled in order to make policy decisions.

Ms. Nienhuis covered Slide 28, "Sources of Unrestricted Revenue":

- Oil - Property tax, Corporate Income Tax, Production Tax (ACES), Royalties. Oil will make up 87% of unrestricted revenue in FY09
- Investment Earnings on General Fund
- Other Non-Oil-Taxes, Charges for Services, Fines and Forfeitures, Licenses and Permits, Rents and Royalties, Miscellaneous

Ms. Nienhuis expanded on the effects of HB 11 [from the 23rd Legislature], the bill that changed the amount of royalties deposited to the permanent fund to 25 percent for all leases until it had a \$20 or more impact on the permanent fund dividend, at which time it would be repealed. Based on the dividend calculation, HB 11 was repealed in October 2008. The royalties are back on the old formula of approximately 32 percent. The change is reflected in a decrease in unrestricted revenue and a corresponding increase in restricted revenue.

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Ms. Nienhuis continued with Slide 29, "FY09 Revenue Overview (General Fund Unrestricted Revenue)." Production tax is close to 50 percent of the total revenue expected. Non-oil revenue makes up about 13 percent. Overall, about 87 percent of unrestricted revenue comes from oil.

Ms. Nienhuis explained Slide 30, "FY09 Non-Oil Revenue Detail." The largest part is related to corporate income tax. Investments are a significant part of non-oil revenue. Typically non-oil revenue has been from 10 to 12 percent of annual unrestricted revenue.

Ms. Nienhuis turned to Slide 31, "FY09 Revenue Forecast Comparison," which compares the fall 2008 forecast with the January 2009 update. The biggest hit was to the production tax at about a 25 percent reduction. Overall the total revenue experienced an 18.2 percent difference. Price is the primary driver; production went down slightly, and cost and investment remained the same.

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Ms. Nienhuis listed conclusions on Slide 32:

- Record level oil price volatility
- Price forecast in "ballpark" when issued
 - o Reduced for interim forecast

- Minimum production level changes from previous forecast
- Lower prices likely to impact future costs and possibly investment

Ms. Nienhuis added that Slide 33 shows more detail on historical production and price changes as of fall 2008 and a change in revenue forecasting from "cash basis" to "accrual basis" accounting:

- Timing issue: Production, prices, and revenue received in July for June production changed from June to July
- Necessary due to significant monthly variation in oil revenues
- Shift in fiscal year affected historical production and price, not revenue
- Greater accuracy in reporting
- Alignment with state financial documents

Ms. Nienhuis detailed the change in accounting systems made in order to be in alignment with other agencies.

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Ms. Nienhuis said that overall the change is good, although the numbers look different. The change is driven by the fact that progressivity in the current tax system drives prices up significantly. Price volatility results in significant revenue volatility.

Co-Chair Stedman asked why the change was made this year. He asked if the Revenue Sources Book notified people of the change. Commissioner Galvin answered that he decided to change the system because of disparities between the DOR report and the Comprehensive Annual Financial Report (CAFR). Revenue for June of 2008 was significantly different than June 2007 revenue and caused a disparity between the CAFR and DOR's report. The structure of the 2008 budget created disparity between the flow of funds and the CAFR. He decided to make the change as historical numbers have never completely added up in the past.

Ms. Nienhuis added that the Revenue Sources Book has a footnote clarifying the change. Commissioner Galvin added that the note was footnote number 1 on page 116 (Revenue Sources Book, Fall 2008). He thought it might be beneficial to continue to publish the footnote in future Revenue Sources Books.

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Senator Thomas queried whether the motor fuel tax listed on Slide 30 was still in existence. Mr. Burnett answered that

the motor fuel tax was not suspended until later in the fiscal year, so there is a partial year reflected.

Co-Chair Stedman asked what date the FY10 price could be expected. Commissioner Galvin thought the FY10 interim revenue forecast would be released February 18 and would include a new price forecast.

Senator Huggins queried why the administration had used the price of \$71 for oil when the 2010 budget was based on an oil price of approximately \$74. Commissioner Galvin answered that the governor's 2010 budget had numbers less than the revenue forecast, which was based on the \$74 price. The \$71 was an approximation of the average price used to balance the governor's budget.

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Senator Huggins asked if there would be a Permanent Fund Dividend. Commissioner Galvin stated that APFD is safe as it is based on a five year rolling number.

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Co-Chair Stedman asked for explanation of how \$200 million in oil and gas taxes is embedded within the budget and whether it was an offset to revenue.

Commissioner Galvin answered that the bulk of the credits in the tax credit program are factored into the revenue projection. The credits accrued by companies with insufficient production will be reflected in the budget as expenditures. The next question is the timing of the payment. The department shows projections in terms of costs in the year in which they are accrued, but when they filter into the budget the question is when the payment will be made. The department thought the system would be faster, that the companies would submit credits earlier and that audit cost reports would be quicker. More will need to be paid out in FY09 than anticipated. The lag time is reflected in the budget.

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Co-Chair Hoffman asked if the expenditures would be considered cash. He thought the expense should be accrued and paid at a later time.

Senator Elton asked what creates the lag time between applications for and payment of the credits. He wondered if the lag was related to a shortage of audit resources or something else the legislature needs to consider. Commissioner Galvin answered that the problem is not a lack

of resources but the extra time required to adjust to a new system.

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Co-Chair Stedman returned to the issue of cash versus accrual accounting and asked for a timeline of how the credits should be paid. He stated concerns about a shortfall for the 2010 budget. Commissioner Galvin promised the information. If the process is established, the need will be spread over several years. Co-Chair Stedman stated concerns. Commissioner Galvin assured the committee that the department shared the concerns.

Co-Chair Hoffman asked how DOR was going to respond to the governor's position on unallocated reductions.

Co-Chair Stedman added concerns about the \$390,000.

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Commissioner Galvin explained that the department responded to the governor's \$390,000 cut from the FY09 budget by not filling vacant positions. Co-Chair Stedman noted that because of the timing, the action was not a response to the collapse of the price of oil. Mr. Burnett explained that the particular cut was decided when the governor signed the budget. The department took action and restricted \$390,000 in spending.

Co-Chair Hoffman emphasized that giving departments the ability to cut services does not reflect policy made by the legislature. He stated that he would not allocate the amount to the department on that basis and wondered if the department would reduce the budget in areas the legislature would not want.

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Commissioner Galvin recognized the legislature's role of setting priorities and establishing authorization for expenditures. He believed the governor should exercise discretion as well. He saw this as part of the give-and-take between the two branches of government.

Co-Chair Stedman asked the dollar amount of the DOR's reduction. Mr. Burnett answered \$390,000. Co-Chair Stedman pointed out that \$390,000 was the same number in the supplemental. He confirmed that the cut had been implemented.

Co-Chair Hoffman did not support what had happened. He stated that if the governor vetoes portions of the budget, the legislature can override the cuts. He thought the

governor was obligated to provide the services put in place by the legislature; he wondered if the department agreed with that process.

Commissioner Galvin stated that he was not trying to establish the administration's policy on the matter. He did not think that the budget set policy on services. He recognized both legislative prerogative to establish the priorities of the state and executive prerogative to take action on the priorities.

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Senator Elton thought the issue [of the separation of powers] was important. He asked if the \$390,000 savings implemented within the department were presented to the committee. Mr. Burnett replied that the department had not yet met with sub-committee chairs in either the House or Senate.

Senator Elton asked if there had been any attempt in the months since the department made the budget changes to let the relevant committees know that the department was not implementing the budget passed by the legislature.

Co-Chair Stedman added that he wondered if attempts of notification had been made in particular to the two operating [budget] co-chairs.

Commissioner Galvin surmised that the underlying question was whether the department was cutting actual public services. He stated that to the best of his knowledge the level of service has not been changed. Individuals were asked to pick up more responsibilities because positions would not be filled. He stated that DOR chose to exercise the governor's request through reducing personnel service costs, and that meant to him that they were stressing the system a little.

Senator Elton did not think the answer was sufficient and wanted more information from the department. He wondered if the department made a \$390,000 mistake when discussing the budget with the legislature the previous year. There may have been million dollar mistakes made in other departments, according to unallocated cuts made in those departments. He was not satisfied with answers given.

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Commissioner Galvin said he could only speak for the Department of Revenue.

Senator Huggins asked how many auditors DOR was short and how the hiring freeze would affect the department.

Commissioner Galvin stated that auditors were a key DOR component; the department has been successful in hiring the master auditors discussed during ACES. He did not know if there were current auditor openings. The governor's hiring freeze allows for exceptions if a department can justify a position as essential. He stated that if a critical auditor position needed to be filled, the department would pursue a waiver.

Senator Huggins asked if there were any new personnel positions in the current budget request. Mr. Burnett did not believe DOR had new positions in the operating budget.

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Co-Chair Stedman stated that the committee has questions about the viability of using the \$200 million oil tax credit. The committee also has interest in the \$50 million put in as a placeholder in the supplemental budget. In addition, he had questions about unallocated expenses that have already taken place, such as in DOR. Finally, he wondered about new spending of \$38.3 million. The committee needed to know about new general fund spending if the unallocated reductions have already been made.

Commissioner Galvin clarified that the unallocated cut was built into the DOR budget as directed by the governor, which meant it would be achieved over the course of the fiscal year.

Co-Chair Stedman stated that the committee would sort details out with OMB and determine a response for revenue differences in the FY09 budget.

[11:14:04 AM](#)

ADJOURNMENT

The meeting was adjourned at 11:13 AM.