

HB

58

Amendment to HB 58

Change title by adding the underlined

An Act relating to certain audits regarding oil and gas royalty and net profits and to audits regarding costs relating to exploration incentive credits and oil and gas exploration licenses; repealing the notice requirement for the issuance of final written findings regarding sale, lease, or disposal of an interest in state land or resources for oil and gas subject to AS 38.05.180(b); and providing for an effective date.

Add to page 4 line 28 the underlined

Sec. 7. AS 38.05.036(d), 38.05.036(e), 38.05.945(a)(3)(B), and AS 43.05.010(15) are repealed.

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

TONY KNOWLES, GOVERNOR

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March 22, 2000

The Honorable Pete Kott
Chair, Judiciary
Alaska State Legislature
State Capitol, MS 3101
Juneau, AK 99801-1182

Dear Representative Kott:

The Department of Natural Resources requests a House Resources Committee hearing on HB 58 "An Act relating to certain audits regarding oil and gas royalty and net profits and exploration licenses". The bill will transfer from the Department of Revenue to the Department of Natural Resources responsibility for audits of oil and gas royalty and exploration licenses and credits. This function has been split between the two departments since 1980 based on a Legislative Audit recommendation and subsequent legislation.

Since 1980, however, the state has entered into royalty settlements and made changes to its tax regulations. In addition, certain fields in the Cook Inlet no longer pay a production tax but are still subject to a royalty. As a result, it is now more beneficial to the state to consolidate the royalty audit function in the Department of Natural Resources. This consolidation will eliminate inefficiencies and duplications in the audit functions.

Thank you for your consideration of this request. It is very important that the state implement efficiencies whenever possible. I look forward to discussing this bill with your committee. If you need additional information concerning HB 58, please call my office at 465-2400.

Sincerely,



John T. Shively
Commissioner

cc: Carol Carroll
Legislative Liaison

"Develop, Conserve and Enhance Natural Resources for Present and Future Alaskans"

**Department of Natural Resources
HB 58**

“An Act relating to certain audits regarding oil and gas royalty and net profits...”

HB 58 bill will transfer the authority to audit royalty revenues from the Department of Revenue (“DOR”) to the Department of Natural Resources (“DNR”). This legislation will create administrative efficiencies and provide DNR with the tools to successfully pursue the state’s interests in its relationship with the oil industry.

Background

Most of state government petroleum revenues come from two sources: production taxes levied by DOR and royalty payments administered by DNR.¹ The calculation of production tax and royalty payments involves very similar arithmetic. In both cases, a percentage of oil and gas production is multiplied by a “netback” value. The netback value is the difference of the price of the oil or gas at the market destination minus marine transportation costs and pipeline tariffs.

DNR and DOR used to conduct audits of their respective revenues independently. In 1980 the legislature consolidated auditing functions under DOR. The legislature felt then that a single audit authority made sense because most of the oil and gas production that was subject to royalty payments was also subject to production taxes. Given the similarity in the calculation of production taxes and royalty payments a single audit was all that was thought was needed.

Since 1980, circumstances have changed and it now makes sense now for the audit authority for royalty to be transferred back to DNR. The impact of the economic limit factor (ELF) means that more oil and gas production is exempt from taxes while royalty payments are still required. For example, oil producers in the Cook Inlet pay no production taxes because of the ELF but they still must pay royalties. The netback calculations required by each department also have become more dissimilar over time. Production taxes are imposed on the oil and gas producer by statute and regulations and each taxpayer calculates the netback value for taxes following identical rules. DNR calculates the netback value on the basis of leases and royalty settlement agreements that have evolved over time and are different for each lessee.

Efficiency

The state will benefit from the specialization of a DNR in-house audit staff and by the elimination of duplication between the departments.

- Specialization. Auditors within DNR participate in the development of royalty valuation methods used in the leases and royalty settlements and are familiar with the logic and history of each lessee’s unique requirements. HB 58 will grant DNR better access to audit

¹ “Royalty payments” in this context refers to both royalty payments and net profit share payments. It is the audit of these revenue streams that are the subject of HB 58.

information and DNR will be able to more efficiently guide audits while they are underway to investigate issues important to the department.²

- **Reduced Duplication:** DNR currently requests a royalty audit after DOR has completed the production tax audit. DOR will start a new audit separate from the original tax audit and includes tax audit information only when possible under the law. In addition to DOR staff assigned to the audit are DNR staff who must be involved in the process as much possible. DNR needs to be familiar with the information acquired in the audit and DNR needs to provide direction and oversight while the audit is conducted. When the audit is completed and delivered to DNR, DOR must keep its own records as well as transmitting copies to DNR. If DNR conducted its own audits, fewer audit staff will be required and there will be no need for inter-department reporting. The paperwork burden for each department will be reduced.

Because the potential for overlapping responsibilities between the departments has decreased over time, a single audit of both taxes and royalty payments is not really possible. HB 58 should not create an additional burden on the taxpayer. In fact, in no other state are the tax and royalty audit functions shared by departments.

What does HB 58 do?

The data provided from these audits are invaluable to DNR when evaluating whether or not its royalty settlement agreements are achieving the correct royalty netback value. As the DNR crafts new valuation methods and sets new lease terms, the audits will reveal what issues need to be considered. It makes sense that DNR acquire audit information first-hand rather than via summary reports and worksheets provided by DOR.

The language in Sections 1, 2, 3, and 5 of HB 58 cleaves the royalty audit role from DOR and transfers the audit authority to DNR. When the legislature granted to DOR the sole authority to audit royalty payments, DOR already had in AS 43 a toolbox to conduct audits. The original AS 38.05.036 was fairly straightforward. HB 58 provides DNR with not only the authority conduct royalty audits but also provides DNR with some tools it will need to conduct audits. These sections also retain for each department the existing authority to acquire data from the other in order to successfully conduct its own audits.

Section 1 also adds a provision to explicitly provide DNR the authority to audit exploration incentive credits awarded under AS 41.09. This remedies an oversight in the original statute where neither DOR nor DNR had such authority.

Parts of Section 4 were added after discussions with industry. Under current law, information collected in a DOR audit is held confidential under threat of criminal penalty. The penalties of divulging information given to DNR and considered confidential under current AS 38.05.035 are not so explicit. Section 4 imposes the same criminal penalty protection on royalty audits

² DOR recognizes the value of specialization and usually assigns the same staff to work on royalty auditor when possible. However, DOR's auditors do not work exclusively on DNR royalty audits.

conducted by DNR. Section 6 provides reciprocal protection when DOR acquires DNR royalty audit data.

Section 4 also extends subpoena powers to DNR. When DOR performs an audit, whether for production tax or royalty, it has the authority under AS 43 to subpoena books and records. HB 58 does not expand the state's power it only transfers existing subpoena powers to DNR. Without this change, the power of the state to audit royalty payments will be diminished. As a practical matter, subpoena powers are rarely exercised.

Fiscal Impact

As noted in the Fiscal Note that accompanies HB 58, three staff are transferred from DOR to DNR at no additional cost to the state. With improved efficiencies, more royalty audits can be completed in the course of a year and the backlog of audits eliminated.

HB 58 achieves an important and simple goal. In the performance of its duties to maximize the value of the state's oil and gas royalty revenues, DNR should conduct its own audits.

FISCAL NOTE

Bill Version: HB 58
 (H) Publish Date: 3/8/00

STATE OF ALASKA 2000 LEGISLATIVE SESSION

BILL

Revision Date: 03-Mar-00 Dept Affected: Natural Resources
 Title: An Act relating to certain audits regarding oil and gas royalty and net profits and to audits regarding costs... BRU: Oil & Gas Development
 Sponsor: Rules Committee Component: Oil & Gas Development
 Requestor: (H)RES Component Serial No. #439

Expenditures/Revenues	(Thousands of Dollars)					
	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006
OPERATING EXPENDITURES						
PERSONAL SERVICES	230.9	230.9	230.9	230.9	230.9	230.9
TRAVEL	2.5	2.5	2.5	2.5	2.5	2.5
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	233.4	233.4	233.4	233.4	233.4	233.4
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES (fund code)	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE	(Thousands of Dollars)					
	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
1105 Perm Fund Receipts	233.4	233.4	233.4	233.4	233.4	233.4
TOTAL	233.4	233.4	233.4	233.4	233.4	233.4

Estimate of any current year (FY00) cost: \$ none

POSITIONS	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006
FULL-TIME	3	3	3	3	3	3
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: *(Attach a separate page if necessary)*

Transfer from the Department of Revenue funds for two Revenue Auditor positions and one clerical position. The Revenue Auditor positions being transferred are filled and perform royalty audits. The departments agree that efficiencies will result in the timeliness of audits with the consolidation of this function in DNR. In the past, many of the tasks required to complete these royalty audits were duplicative of tasks performed in DNR. This fiscal note shows the transfer of the funds and positions from Dept. of Revenue to the Dept. of Natural Resources.

Prepared by: Ken Boyd, Director Phone: 269-8800
 Division: Oil & Gas Date: 03-Mar-00
 Approved by Commissioner: John Shively Date: 03-03-00
 Agency: Natural Resources

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FISCAL NOTE

Bill Version: HB 58

(H) Publish Date: 3/8/00

**STATE OF ALASKA
2000 LEGISLATIVE SESSION**

Revision Date/Time (Note if correction) March 3, 2000 - 3 p.m. Dept. Affected Revenue
 Title Oil & Gas Audits BRU Revenue Operations
 Component Tax Division
 Sponsor House Rules
 Requester House Resources Component No. 115

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services	(230.9)	(230.9)	(230.9)	(230.9)	(230.9)	(230.9)
Travel	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Permanent Fund receipts)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)
TOTAL	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)

Estimate of any current year (FY2000) cost: _____

POSITIONS

Full-time	-3	-3	-3	-3	-3	-3
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill transfers from DOR to DNR the responsibilities and authority for auditing reports and payments relating to revenue under oil and gas contracts, agreements and leases. This function is performed by three DOR positions that would be transferred from DOR to DNR.

The DOR positions had been funded with General Fund money but the Legislature in 1999 changed the funding source starting with the FY 2000 budget to Permanent Fund Receipts.

Prepared by: Dan Dickinson, Director Phone 269-1033
 Division Tax Division Date/Time March 3, 2000
 Approved by: Commissioner Wilson Condon Date 03/03/2000
 Agency Department of Revenue

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FISCAL NOTE

Bill Version: HB 58

(H) Publish Date: 1/22/99

**STATE OF ALASKA
1999 LEGISLATIVE SESSION**

Revision Date/Time (Note if correction) _____ Dept. Affected Revenue
 Title Oil & Gas Audits/Incentive Credit BRU Revenue Operations
 Component Oil & Gas Audit Division
 Sponsor Rules
 Requester Governor Component Serial No. _____

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Personal Services	(230.9)	(230.9)	(230.9)	(230.9)	(230.9)	(230.9)
Travel	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)

CAPITAL EXPENDITURES						
-----------------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)	(233.4)

Estimate of any current year (FY99) cost: _____

POSITIONS

Full-time	-3	-3	-3	-3	-3	-3
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill transfers from DOR to DNR the responsibilities and authority for auditing reports and payments relating to revenue under oil and gas contracts, agreements and leases. This function is performed by two DOR auditor positions and one clerk position that would be transferred from DOR to DNR.

Prepared by John F. Pilkinton, Director
 Division Oil & Gas Audit
 Approved by Wilson L. Condon
 Commissioner
 Agency Department of Revenue

Phone 907-343-9225
 Date/Time Oct. 30, 1998
 Date Oct. 30, 1998

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FISCAL NOTE

Bill Version: HB 58

(H) Publish Date: 1/22/99

STATE OF ALASKA 1999 LEGISLATIVE SESSION

Revision Date: _____ Dept Affected: Natural Resources
 Title: An Act relating to certain audits regarding oil BRU: Oil & Gas Development
and gas royalty and net profits and to audits regarding costs... Component: Oil & Gas Development
 Sponsor: House and Senate Rules Committees
 Requestor: Governor Component Serial No. #439

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY00	FY01	FY02	FY03	FY04	FY05
PERSONAL SERVICES	230.9	230.9	230.9	230.9	230.9	230.9
TRAVEL	2.5	2.5	2.5	2.5	2.5	2.5
CONTRACTUAL SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	233.4	233.4	233.4	233.4	233.4	233.4
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES (fund code)	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	233.4	233.4	233.4	233.4	233.4	233.4
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	233.4	233.4	233.4	233.4	233.4	233.4

Estimate of any current year (FY99) cost: \$ none

POSITIONS

FULL-TIME	3	3	3	3	3	3
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Transfer from the Department of Revenue funds for two Revenue Auditor positions and one clerical position. The Revenue Auditor positions being transferred are filled and perform royalty audits. The departments agree that efficiencies will result in the timeliness of audits with the consolidation of this function in DNR. In the past, many of the tasks required to complete these royalty audits were duplicative of tasks performed in DNR. This fiscal note shows the transfer of the funds and positions from Dept. of Revenue to the Dept. of Natural Resources.

Prepared by: Ken Boyd, Director Phone: 269-8800
 Division: Oil & Gas Date: 26-Oct-98
 Approved by Commissioner: [Signature] Date: 10-26-98
 Agency: Natural Resources

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HD 58

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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

January 20, 1999

The Honorable Brian Porter
Speaker of the House
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Brian
Dear Speaker Porter:

In the interest of improving efficiency within our state government, as well as between government and industry, I am transmitting this bill to transfer oil and gas royalty audit functions from the Department of Revenue (DOR) to the Department of Natural Resources (DNR). It makes sense to put the audit duties in the same department that administers, enforces, and is therefore most knowledgeable with, the oil and gas leasing program.

Ironically, the audit functions used to rest with DNR, but were switched to DOR in 1980 based on a legislative audit report. The recommendation stated cost savings would be achieved by having one staff of auditors review both tax and royalty compliance information. Since 1980, however, the state has entered into royalty settlements with the major North Slope producers and has made changes to its tax regulations. As a result, there is no longer as much overlap between royalty and tax audits. In addition, separating DNR's duty to administer and enforce oil and gas contracts, agreements, and leases from the department's ability to conduct audits leading to possible enforcement actions, has resulted in inefficiencies and other problems.

The bill specifically authorizes DNR to audit reports and costs relating to exploration incentive credits and oil and gas licenses. It also grants DNR audit powers commensurate to those of DOR currently, including the right to subpoena information for audit purposes. The two departments would be allowed to exchange confidential information obtained in the course of their respective audits; a breach of confidentiality by any agency employee would be a felony offense.

This bill takes a sensible step in how the state does business with the oil and gas industry.

Sincerely,



Tony Knowles
Governor