

**State of Alaska**  
**FY2003 Governor's Operating Budget**

**Department of Revenue**  
**Revenue Operations**  
**Budget Request Unit Budget Summary**

## Revenue Operations Budget Request Unit

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### BRU Mission

To administer the state's tax and charitable gaming laws to collect revenue efficiently and to treat taxpayers, permittees and licensees equitably; to equitably, efficiently and expeditiously administer and collect oil and gas production and property taxes and royalties and to assist policy makers with oil and gas issues; to prudently manage the state's financial assets; and to prudently manage and invest state pension funds.

### BRU Services Provided

#### TAX DIVISION

- Administer 19 tax types including four special oil and gas taxes, six fisheries taxes and nine excise, income and other tax types, providing over half of non-federal General Fund revenues, including development and processing of tax returns, collection of and accounting for revenues, compliance and taxpayer service.
- Administer three non-tax programs: charitable gaming, royalty auditing and salmon price reporting.

#### TREASURY

- Manage the investments of state funds under the fiduciary responsibility of the commissioner of Revenue, or as requested by other fiduciaries: General Fund, International Airport Bond Funds, Constitutional Budget Reserve Fund, Student Loan Bond Funds, Children's Trust, Advanced College Education Tuition Fund, Public School Trust Fund, Retiree Health Insurance Fund and University of Alaska Trust Fund.
- Provide consultative cash management services to all state agencies.
- Provide consultative capital financing services to state agencies.
- Provide staff to the Alaska State Pension Investment Board, State Bond Committee and Alaska Municipal Bond Bank Authority.

#### ALASKA STATE PENSION INVESTMENT BOARD

- Invest the funds of the state defined benefit pension plans: Public Employees Retirement System Trust, Teachers Retirement System Trust, Judicial Retirement System Trust, Naval Militia Retirement System Trust.
- Recommend appropriate investment options for the Supplemental Benefits Annuity Plan and the Deferred Compensation Plan to the plan fiduciary, the Commissioner of Administration.

### BRU Goals and Strategies

#### TAX DIVISION

- Streamline and simplify the fisheries business tax licensing and filing process to reduce the administrative burden on taxpayers and foster tax compliance.
- Design and implement software to eliminate unnecessary examination effort currently being performed on 70% of corporate returns filed.
- Create a cost effective-based electronic filing and licensing application development process.
- Redesign forms and software to obtain and process shared revenue data more efficiently.
- Increase use of computerized filing of reports and other required information with an emphasis on oil and gas taxes where most taxpayers are fairly sophisticated.
- Emphasize up-front compliance and consultation with the taxpayers rather than after the fact audits to arrive at correct amount for production tax.
- Increase the scope of communication and consultation between municipal and industry stakeholders in the administration of oil and gas property taxes.

- Continue the process of overhauling the Revenue Sources book to increase its usefulness and information content.
- Stay on track for resolving oil and gas production tax matters timely.
- Continue trying to set up a mechanism for an annual projection of revising any regulation where ambiguity has led to a compromised assessment.

#### TREASURY

1. Maximize the investment rate of return on investment portfolios consistent with statutes and fiduciary standards without incurring undue risks.
  - Manage the funds in accordance with the stated asset allocation objectives and constraints.
  - Meet or exceed established investment benchmarks/targets over the appropriate time horizon.
  - Minimize uninvested cash through the automation of the collection and deposit of state receipts.
2. Assist state agencies with their conversion to electronic remittances of revenues and related information.
  - Automate collection of retirement contributions, unemployment insurance and workers compensation payments, oil and gas and court systems payments via Automated Clearing House (ACH).
  - Work with agencies to clear treasury receipts within 15 days to reduce CBRF borrowing for cash flow.
3. Issue and manage state debt at minimum costs to the state.
  - Issue debt for capital financing and pursue refinancing opportunities to reduce interest costs when feasible.
  - Maintain the state's bond rating.

#### ALASKA STATE PENSION INVESTMENT BOARD

1. Maximize the investment rate of return on funds managed consistent with fiduciary standards.
  - Manage the trusts in accordance with the stated asset allocation objectives and constraints.
  - Meet or exceed established investment benchmarks/targets over the appropriate time horizons.

### **Key BRU Issues for FY2002 – 2003**

#### TAX DIVISION

Key legislation passed in 2001 included:

- HB 154 (Ch 42 SLA 2001), Fisheries Business Tax/Fishery Resource Landing Tax. This bill modified the tax payment security requirements necessary to obtain a state fisheries business tax license.
- HB 228 (Ch 88 SLA 2001), Sale of Tobacco Products. Relevant sections in this bill gave the division new tools to enforce the nationwide Master Settlement Agreement signed by the major cigarette producers and states.
- SB 151 (Ch 78 SLA 2001), Bristol Bay Salmon Classic. The state's charitable gaming laws allow certain organizations to conduct "salmon classic" games of chance. This legislation adds the Bristol Bay Native Corporation Education Foundation to the list, allowing the education foundation to conduct a fund-raising salmon classic.
- SB 158 (Ch 38 SLA 2001), Study of State Participation in Gas Line Ownership. This legislation directs the department to prepare a detailed report on the merits of the state ownership and/or financial stake in North Slope natural gas commercialization project.

Key Issues for 2002- 2003:

- Creating and maintaining effective information technology programs, which will require retaining and attracting high quality personnel.
- Keep current with analysis and research pertinent to developments with a proposed Alaska natural gas project.
- Auditing oil and gas related taxes for 2000, which include major transition and adjustments for all out major taxpayers.
- Bringing in a new state petroleum properties assessor and administering the property tax laws (AS 43.56) when tensions between municipalities and taxpayers seem to be on the increase.

#### TREASURY

- Key issues for cash management relate to Alaska's geographical dispersion of population and the difficulty of

access to communities, which, because it makes traditional paper-based transactions problematic, puts a premium on technologies that do not rely on traditional forms of transportation. Accordingly, treasury is involved in the development of cutting-edge technology for cash management, which requires effort and time to reach the desired goal.

- Primary key issues for portfolio management include dealing with the financial and economic turmoil caused by the terrorist attacks of September 11, as well as managing investment risk in the current low interest rate environment. A key issue for the state comptroller will be implementation of a holder compliance program for unclaimed property.

#### ALASKA STATE PENSION INVESTMENT BOARD

- Key issues for the board include dealing with the financial and economic turmoil caused by the terrorists attacks of September 11. The board also is committed to continuing to improve the investment program for participants in the Supplemental Benefits System and Deferred Compensation Plans.

### Major BRU Accomplishments in 2001

#### TAX DIVISION

- During FY 2001 the division implemented new regulations and enhancements to the tax database for motor fuel tax, resulting in fewer staff hours necessary to record taxpayer data.
- The new Alaska Salmon Price Report requirements were implemented in FY 2001 by the creation of a database and reporting system to meet the requirements of HB 363.
- FY 2001 also brought about the division computerized time reporting system, allowing for more accurate reporting of staff hours charged to tax programs.
- Continued to improve use of Information technology in tax programs. We designed and implemented a new data entry and return examination application for motor fuel tax. This will be expanded to corporate income tax.
- Stayed on schedule for closing out oil and gas production tax (AS 43.55) matters, closing all matters through 1996 and all audits through 1997 (two matters left in appeals)
- Participated in TAPS hearing before the State Assessment Review Board and essentially held a middle ground valuation that was \$1 billion higher than requested by taxpayers and \$3 billion lower than requested by municipalities
- Put out an effective and informative Revenue Sources book that explored fiscal options and their economic impacts
- Completed substantial work on new regulations package concerning allowable transportation deductions under the state's oil and gas production tax laws.

#### TREASURY DIVISION

- ♦ The following funds exceeded their benchmarks in 2001: the General Fund, Alaska Children's Trust, CBRF, Exxon Valdez Oil Spill Trust Fund, Retiree Health Insurance Long-term Care and Major Medical Funds, Public School Trust, and International Airports Revenue and Construction Funds.
- Implemented a securities lending program that should return \$1.5 million per year to the various funds Treasury manages.
- Issued ACH origination contract to allow for both disbursements and collection of funds electronically.
- Added several new locations to existing credit card contract.
- Implemented a master lease program to allow tax-exempt financing of smaller purchases that were previously financed at taxable rates or purchased.
- Facilitated a \$9 million lease purchase transaction for DOT statewide equipment fleet.
- Issued \$2.33 million in bond anticipation notes for the Clean Water and Drinking Water Funds.

#### ALASKA STATE PENSION INVESTMENT BOARD

- In 2001 the Public Employees and Teachers Retirement Systems both exceeded their benchmark returns.
- The board implemented a securities lending program.
- The board added several new options to the Deferred Compensation and the Supplemental Benefits System Plans to improve participants' investment choices.
- The board terminated several investment managers and reallocated those investments to improve returns going forward. Reallocating to existing managers also resulted in a reduction of over \$2 million in annual management fees.

## Key Performance Measures for FY2003

### Measure:

ASPIB: Investment returns expressed in terms of most recent five-year and one-year averages measured against performance benchmarks.

Sec 134 (b) (1) Ch 90 SLA 2001(HB 250)

### Alaska's Target & Progress:

Fund // FY2000 five-year actual return // FY2000 five-year benchmark return

The following returns are for the five-year period ending June 30, 2000:

- Public Employees Retirement Trust Fund // 13.43% // 13.23%
- Teachers Retirement Trust Fund // 13.61% // 13.23%
- Military Retirement Trust Fund // 10.30% // 11.17%

The following returns are for the three-year period ended June 30, 2000:

- Judicial Retirement Trust Fund // 10.51% // 11.32%

### Benchmark Comparisons:

The benchmark return for each fund depends upon its asset allocation -- the mix of different asset classes that Treasury has invested it in. Each fund's individual benchmark return (as reported above) is calculated by weighting the percent of any asset class it holds by the appropriate asset class benchmark below:

- Domestic Equity - Russell 2000 Stock Index or the S&P 500 Stock Index
- International Equity - Morgan Stanley Capital International Europe, Australia and Far East Stock Index (EAFE)
- Domestic Fixed Income - Lehman Brothers Aggregate Bond Index
- International Fixed Income - Non-US Government Bond Index

### Measure:

ASPIB: Administrative costs per dollar of investment.

Sec 134 (b) (2) Ch 90 SLA 2001(HB 250)

### Alaska's Target & Progress:

- The Treasury Division participated in a national Defined Benefit Pension Fund Survey regarding calendar year 2000 costs (performed by Cost Effectiveness Measurement Inc.). The universe included 250 plans from Canada and the United States, representing both public and private funds. Total United States assets represented in the survey were \$1,868 billion.
- Relevant findings of this survey include: ASPIB's 2000 total operating costs were 32 basis points compared to the US average cost of 35 basis points. The benchmark cost (which can be thought of, generally, as the average cost for a fund of ASPIB's size and asset mix) was 28 basis points.

### Benchmark Comparisons:

- These results above compare to benchmarks established by Cost Effectiveness Measurement Inc. ASPIB will continue to participate in this annual survey while looking for others to participate in as well. Year-to-year trends will also be evaluated as we would expect our per dollar of investment cost to decrease as the asset size grows.

### Background and Strategies:

- The results of this survey need to be interpreted cautiously. Comparing our costs to the overall average may be misleading because costs per dollar of investment is first and foremost a function of the size of the assets and this survey had approximately one-third of the participants with plan sizes under \$2 billion and the remaining two-

thirds of the participants with plan sizes over \$2 billion.

- With a benchmark cost of 28 basis points compared to an actual cost of 32 basis points, we would be considered a low-cost provider (as opposed to a high or normal cost provider). While this calculation compares like-sized funds, it does not account for differences that are caused by asset allocation and passive versus active management decisions.

**Measure:**

Treasury Division: Investment returns against performance benchmarks.  
Sec 133 (b) (1) Ch 90 SLA 2001(HB 250)

**Alaska's Target & Progress:**

Annual returns for the most recent fiscal year are provided below.

Fund // FY 2001 five-year actual return // FY2001 five-year benchmark return

- General Fund and Other Non-Segregated Investments (GeFONSI) // 6.34% // 6.25%
- CBRF (main account) // 7.35% // 6.50%
- Alaska Children's Trust // 11.26% // 10.54%
- Public School Trust Fund // 11.85% // 10.54%
- International Airports Revenue Fund // 6.45% // 6.09%

Fund // FY 2001 one-year actual return // FY2001 one-year benchmark return

- International Airports Construction Funds // 9.20% // 8.81%
- CBRF (subaccount) // (6.01%) // (5.57%)
- RHIF/Long-term Care Fund // (5.60%) // (7.25%)

Fund // FY 2001 three-year actual return // FY2001 three-year benchmark return

- RHIF/Major Medical Fund // 6.11% // 5.80%

**Benchmark Comparisons:**

The benchmark return for each fund depends upon its asset allocation -- the mix of different asset classes that Treasury has invested it in. Each fund's individual benchmark return (as reported above) is calculated by weighting the percent of any asset class they hold by the appropriate asset class benchmark below.

- For the Short-Term Fixed-Income Investment Pool – three-month US Treasury Bill
- For the Intermediate-Term Fixed-Income Investment Pool - Merrill Lynch 1- to 5-year Government Index
- For the Long-Term Fixed-Income Pool - Lehman Brothers Aggregate Index
- For the Domestic Equity Common Trust - Russell 3000 Index
- For the International Equity Common Trust - Morgan Stanley Capital International Europe, Australia and Far East Index (EAFE)

**Measure:**

Treasury Division: Administrative costs per dollar of investment.  
Sec 133 (b) (2) Ch 90 SLA 2001(HB 250)

**Alaska's Target & Progress:**

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- Relevant findings of this survey include: ASPIB's 2000 total operating costs were 32 basis points compared to the US average cost of 35 basis points. The benchmark cost (which can be thought of, generally, as the average cost for a fund of ASPIB's size and asset mix) was 28 basis points.

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**Background and Strategies:**

- The results of this survey need to be interpreted cautiously. Comparing our costs to the overall average may be misleading because costs per dollar of investment is first and foremost a function of the size of the assets and this survey had approximately one-third of the participants with plan sizes under \$2 billion and the remaining two-thirds of the participants with plan sizes over \$2 billion.
- With a benchmark cost of 28 basis points compared to an actual cost of 32 basis points, we would be considered a low cost provider (as opposed to a high or normal cost provider). While this calculation compares like-sized funds, it does not account for differences that are caused by asset allocation and passive versus active management decisions.

**Measure:**

Tax Division: The division budget as compared to the total amount collected by the division.  
Sec 135 (b) (1) Ch 90 SLA 2001(HB 250)

**Benchmark Comparisons:**

All dollar figures in millions

- Division budget: \$6.7 million
- Division collections: \$1,344.4 million
- Cost of collections vs. total collections 0.5%

This compares very well with a "benchmark rule of thumb" of tax collection costing 1% of collected revenues.

**Measure:**

Tax Division: The percentage of taxes collected as compared to the percentage of taxes due.  
Sec 135 (b) (2) Ch 90 SLA 2001(HB 250)

**Benchmark Comparisons:**

All dollar figures in millions

- Division collections: \$1,344.4
- Division assessments: \$1,355.6
- Comparison: 99.2%

**Measure:**

Tax Division: The time expended compared to the time budgeted and the average time taken to complete audits.  
Sec 135 (b) (3) Ch 90 SLA 2001(HB 250)

**Benchmark Comparisons:**

- Actual audit hours 17,432
- Estimated/budgeted audit hours 19,335
- Comparison: 90.2%

**Measure:**

Tax Division: The amount of assessments disallowed on appeal as compared to the amount of assessments claimed.  
Sec 135 (b) (4) Ch 90 SLA 2001(HB 250)

**Benchmark Comparisons:**

All dollar figures in millions

- Appealed tax and penalty assessments claimed \$27.20
- Disallowed tax and penalties: (\$2.50)

Note: This is negative because the State Assessment Review Board INCREASED the amount of tax in their ruling on an appealed case.

**Revenue Operations**  
**BRU Financial Summary by Component**

*All dollars in thousands*

	FY2001 Actuals				FY2002 Authorized				FY2003 Governor			
	General Funds	Federal Funds	Other Funds	Total Funds	General Funds	Federal Funds	Other Funds	Total Funds	General Funds	Federal Funds	Other Funds	Total Funds
<b><u>Formula Expenditures</u></b>												
None.												
<b><u>Non-Formula Expenditures</u></b>												
Treasury Management	1,340.2	0.0	1,933.9	3,274.1	1,442.7	0.0	2,020.9	3,463.6	1,346.5	0.0	2,220.0	3,566.5
AK State Pension	0.0	0.0	2,864.0	2,864.0	0.0	0.0	3,195.5	3,195.5	0.0	0.0	3,374.2	3,374.2
Investment Bd ASPIB Custody and Mgt Fee	0.0	0.0	27,137.8	27,137.8	0.0	0.0	33,713.6	33,713.6	0.0	0.0	0.0	0.0
Tax Division	6,216.6	0.0	452.7	6,669.3	6,405.1	0.0	565.1	6,970.2	6,365.9	0.0	375.0	6,740.9
Language Section	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	125.0	0.0	0.0	125.0
<b>Totals</b>	<b>7,556.8</b>	<b>0.0</b>	<b>32,388.4</b>	<b>39,945.2</b>	<b>7,847.8</b>	<b>0.0</b>	<b>39,495.1</b>	<b>47,342.9</b>	<b>7,837.4</b>	<b>0.0</b>	<b>5,969.2</b>	<b>13,806.6</b>

## Revenue Operations

### Proposed Changes in Levels of Service for FY2003

#### TREASURY DIVISION

The division is requesting two increments for Fiscal 2003:

- \$27,500 to increase a half-time unclaimed property worker to full-time to increase the recovery of assets belonging to Alaskans and, subsequently, to increase deposits to the General Fund. This would include increased work with banks and other financial institutions to ensure property is turned in to Alaska and not other states.
- \$200,000 (\$150,000 ASPIB and other funds and \$50,000 General Funds) to fund personal services. This would cover the raises approved for investment officers and other personnel. In past years, Treasury has taken from other budget categories to cover personal services in past years but can no longer absorb the cost. The state must remain competitive with its salaries if it is to attract and retain quality investment personnel to manage the public's multi-billion-dollar portfolio. The Treasury Division determined a fair and reasonable salary level for its investment officers after surveying other operations in Alaska and consulting national averages.

## Revenue Operations

### Summary of BRU Budget Changes by Component

#### From FY2002 Authorized to FY2003 Governor

*All dollars in thousands*

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
<b>FY2002 Authorized</b>	<b>7,847.8</b>	<b>0.0</b>	<b>39,495.1</b>	<b>47,342.9</b>
<b>Adjustments which will continue current level of service:</b>				
-Treasury Management	-173.7	0.0	49.1	-124.6
-Tax Division	-42.0	0.0	-190.1	-232.1
-Language Section	125.0	0.0	0.0	125.0
<b>Proposed budget increases:</b>				
-Treasury Management	77.5	0.0	150.0	227.5
-AK State Pension Investment Bd	0.0	0.0	178.7	178.7
-Tax Division	2.8	0.0	0.0	2.8
<b>FY2003 Governor</b>	<b>7,837.4</b>	<b>0.0</b>	<b>5,969.2</b>	<b>13,806.6</b>