

**State of Alaska**  
**FY2004 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, Public School Trust Fund, Retiree Health Insurance Fund and University of Alaska Trust Fund.
- Provide training and consultative cash management services to all state agencies.
- Provide consultative capital financing services to state agencies and the legislature.
- 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

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.

Assist state agencies with their conversion to electronic remittances of revenues and related information.

- Automate collection of tax, insurance, and DMV dealer receipts using system developed with Department of Administration's Information Technology Group.
- Work with agencies to develop a clearer understanding of the impact of their operations on general fund cash and CBRF borrowing.

Issue and manage state debt to achieve the lowest cost of capital to the state.

- Issue debt for capital financing and pursue refinancing opportunities to reduce interest costs when feasible.
- Maintain the state's bond rating.
- Provide technical assistance as needed.

#### ALASKA STATE PENSION INVESTMENT BOARD

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 FY2003 – 2004**

#### TAX DIVISION

- 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 our 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 investment risk in the current low interest rate environment.

#### 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 2002

### 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 2002: the Retiree Health Insurance Long-Term Care Fund and the Public School Trust.
- Implemented a significant upgrade to existing treasury management workstation from an outdated DOS-based to more efficient, Windows-based system.
- Issued RFP and reviewed bids for credit card acceptance contract.
- Assisted CSED with review of daily and monthly bank reconciliations.
- Decreased balance of treasury suspense by a daily average of \$10 million, making this money available to meet the daily obligations of the general fund.
- Completed first year of master lease program for equipment purchases.
- Issued \$16 million in Certificates of Participation to fund construction of the new Alaska Psychiatric Institute.
- Issued \$140.78 million in State of Alaska, International Airports System revenue bonds to fund two years of the system's capital improvement program.
- Issued \$2.4 million in Bond Anticipation notes for the Clean Water and Drinking Water Funds.

### ALASKA STATE PENSION INVESTMENT BOARD

- In 2002 the Public Employees and Teachers Retirement Systems both exceeded their benchmark returns. The Judicial Retirement System Trust also exceeded its benchmark return.

## Key Performance Measures for FY2004

### 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 124 SLA 2002(HB 515)

### Alaska's Target & Progress:

#### FUND

- Actual five year return for the period ending June 30 2002 // 2001 // 2000 // 1999 // 1998
- Benchmark five-year return for period ending June 30, 2002 // 2001 // 2000 // 1999 //1998

- Actual one year return // Benchmark one year return

#### PUBLIC EMPLOYEES RETIREMENT SYSTEM TRUST

- Actual five-year returns 4.57% // 9.35% // 13.43% // 14.54% // 12.86%
- Benchmark returns 4.90% // 9.21% // 13.23% // 14.91% // 12.83%
- Actual one year return -5.48% // Benchmark one year return 4.36%

#### TEACHERS RETIREMENT SYSTEM TRUST

- Actual five-year returns 4.60% // 9.37% // 13.61% // 14.77% // 13.05%
- Benchmark returns 4.90% // 9.21% // 13.23% // 14.91% // 12.83%
- Actual one year return -5.49% // Benchmark one year return 4.36%

#### MILITARY RETIREMENT SYSTEM

- Actual five-year returns 5.47% // 8.63% // 10.36% // 11.11% // 10.05%
- Benchmark returns 5.63% // 9.11% // 11.70% // 13.47% // 11.86%
- Actual one year return -2.13% // Benchmark one year return -1.69%

#### JUDICIAL RETIREMENT SYSTEM

- Actual five-year returns 5.16% // 8.55% // 11.18% // 12.03% // 10.44%
- Benchmark returns 5.18% // 9.15% // 12.63% // 13.93% // 12.55%
- Actual one year return -2.75% // Benchmark one year return -3.33%

#### Benchmark Comparisons:

The benchmark return for each fund depends upon its asset allocation -- the mix of different asset classes that Treasury has invested 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 124 SLA 2002(HB 515)

#### Alaska's Target & Progress:

- The Treasury Division participated in a national Defined Benefit Pension Fund Survey regarding calendar year 2001 and 2000 costs (performed by Cost Effectiveness Measurement Inc.). The universe for 2001 included 260 plans from Canada and the United States, representing both public and private funds. Total United States assets represented in the survey were \$1,765 billion.

Relevant findings of this survey include: ASPIB's 2001 and 2000 total operating costs were 34 and 32 basis points, respectively, compared to the US average cost of 37 and 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 37 and 28 basis points, respectively.

#### 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 2001 and 2000 benchmark costs of 37 and 28 basis points, respectively, compared to actual costs of 34 and 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 124 SLA 2002(HB 515)

**Alaska's Target & Progress:**

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

Fund // FY 2002 actual return // FY2002 benchmark return

- General Fund and Other Non-Segregated Investments (GeFONSI) // 4.63% // 5.75%
- CBRF (main account) // 6.11% // 7.02%
- Alaska Children's Trust // -3.64% // -3.37%
- Public School Trust Fund // -3.13% // -3.37%
- International Airports Revenue Fund // 5.55% // 6.92%
- CBRF (subaccount) // -5.61% // -5.31%
- RHIF/Long-term Care Fund // -6.30% // -6.69%
- RHIF/Major Medical Fund // 6.14% // 6.54%

**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 124 SLA 2002(HB 515)

**Alaska's Target & Progress:**

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- With 2001 and 2000 benchmark costs of 37 and 28 basis points, respectively, compared to actual costs of 34 and 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 124 SLA 2002(HB 515)

**Alaska's Target & Progress:**

All dollar figures in millions

Fiscal 2002

- Division budget: \$6.6
- Division collections: \$1,216.8
- 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.

Fiscal 2001	0.5%
Fiscal 2000	0.4%
Fiscal 1999	0.8%
Fiscal 1998	0.5%

**Measure:**

**Tax Division: The percentage of taxes collected as compared to the percentage of taxes due.**

Sec 135 (b) (2) Ch 124 SLA 2002(HB 515)

**Alaska's Target & Progress:**

All dollar figures in millions

Fiscal 2002

- Division collections: \$1,216.8
- Division assessments: \$1,259.4
- Comparison: 99.6%

Fiscal 2001	99.2%
Fiscal 2000	94.9%
Fiscal 1999	95.8%
Fiscal 1998	90.8%

**Measure:**

**Tax Division: The time expended compared to the time budgeted and the average time taken to complete audits.**

Sec 135 (b) (3) Ch 124 SLA 2002(HB 515)

**Alaska's Target & Progress:**

Fiscal 2002

- Actual audit hours 14,654
- Estimated/budgeted audit hours 12,140
- Comparison: 120.7%

**Measure:**

**Tax Division: The amount of assessments disallowed on appeal as compared to the amount of assessments claimed.**

Sec 135 (b) (4) Ch 124 SLA 2002(HB 515)

**Alaska's Target & Progress:**

Fiscal 2002

All dollar figures in millions

- Disallowed Tax and Penalties: 0.01
- Appealed Tax and Penalty Assessments: 0.38
- Comparison: 2.6%



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

*All dollars in thousands*

	FY2002 Actuals				FY2003 Authorized				FY2004 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	1,337.7	0.0	2,128.6	3,466.3	1,384.0	0.0	2,220.0	3,604.0	1,386.9	0.0	2,296.5	3,683.4
AK State Pension	0.0	0.0	2,928.2	2,928.2	0.0	0.0	3,374.2	3,374.2	0.0	0.0	3,374.2	3,374.2
Investment Bd												
ASPIB Custody and Mgt Fee	0.0	0.0	22,463.7	22,463.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax Division	6,395.8	0.0	381.1	6,776.9	6,313.7	0.0	425.0	6,738.7	6,160.2	0.0	479.1	6,639.3
<b>Totals</b>	<b>7,733.5</b>	<b>0.0</b>	<b>27,901.6</b>	<b>35,635.1</b>	<b>7,697.7</b>	<b>0.0</b>	<b>6,019.2</b>	<b>13,716.9</b>	<b>7,547.1</b>	<b>0.0</b>	<b>6,149.8</b>	<b>13,696.9</b>

**Revenue Operations**  
**Proposed Changes in Levels of Service for FY2004**

See individual components.

**Revenue Operations**  
**Summary of BRU Budget Changes by Component**  
**From FY2003 Authorized to FY2004 Governor**

*All dollars in thousands*

	<u>General Funds</u>	<u>Federal Funds</u>	<u>Other Funds</u>	<u>Total Funds</u>
<b>FY2003 Authorized</b>	7,697.7	0.0	6,019.2	13,716.9
<b>Adjustments which will continue current level of service:</b>				
-Treasury Management	-122.1	0.0	16.5	-105.6
-Tax Division	-53.5	0.0	54.1	0.6
<b>Proposed budget decreases:</b>				
-Tax Division	-100.0	0.0	0.0	-100.0
<b>Proposed budget increases:</b>				
-Treasury Management	125.0	0.0	60.0	185.0
<b>FY2004 Governor</b>	<b>7,547.1</b>	<b>0.0</b>	<b>6,149.8</b>	<b>13,696.9</b>