

**Contract Auditors for Reducing Royalty and Net Profit  
Share Lease Audit Backlogs**

**FY2009 Request: \$200,000  
Reference No: 45279**

**AP/AL:** Appropriation  
**Category:** Natural Resources  
**Location:** Statewide  
**House District:** Statewide (HD 1-40)  
**Estimated Project Dates:** 07/01/2008 - 06/30/2009

**Project Type:** Planning  
**Contact:** Leta Simons  
**Contact Phone:** (907)465-2400

**Brief Summary and Statement of Need:**

This project will fund the cost of outside contract auditors to reduce or eliminate the current backlog of royalty and net profit share lease audits.

<b>Funding:</b>	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	Total
AK Cap Inc	\$200,000						\$200,000
<b>Total:</b>	\$200,000	\$0	\$0	\$0	\$0	\$0	\$200,000

<input type="checkbox"/> State Match Required	<input checked="" type="checkbox"/> One-Time Project	<input type="checkbox"/> Phased - new	<input type="checkbox"/> Phased - underway	<input type="checkbox"/> On-Going
0% = Minimum State Match % Required		<input type="checkbox"/> Amendment	<input type="checkbox"/> Mental Health Bill	

**Operating & Maintenance Costs:**

	<u>Amount</u>	<u>Staff</u>
Project Development:	0	0
Ongoing Operating:	0	0
<u>One-Time Startup:</u>	0	
<b>Totals:</b>	0	0

**Additional Information / Prior Funding History:**

This is a new project request - no prior funding history.

**Project Description/Justification:**

The Division of Oil and Gas, Audit Section is responsible for auditing and reviewing the royalties and net profit share lease payments made by oil and gas producers. In fiscal year 2007, the Division of Oil and gas received \$2.1 billion in royalties and net profit share payments. The Audit Section is responsible for determining that this essential state revenue component is reported accurately by oil and gas producers and in compliance with state laws and leases through audits and other reviews. The Audit Section collected \$10.7 million in audit recoveries in FY 2007. The division's audits include analysis of oil and gas production on the North Slope and in Cook Inlet, and involve the analysis of upstream operations and capital costs claimed by the producers, and also deductions relating to marine transportations costs, pipeline tariffs, sales proceeds at the destination markets, liquefied natural gas (LNG) plant costs, fuel costs and other information relating to royalty and net profit share values. The division's auditors also analyze oil and gas producer costs and revenues in connection with royalty settlement agreements and other commercial and financial projects within the division.

The division needs to contract with outside auditors to perform one or more audits because the division currently has a backlog of audits. The division's net profit share audits, in which certain of a producer's upstream oil and gas operating and capital costs are eligible as a deduction against a producer's net profit share lease (NPSL) payment to the state, are especially in need of additional audit resources as one NPSL audit is currently 12 years behind the date of production and another NPSL audit is six years behind the date of production. The Audit Section currently has seven auditors, who are currently conducting NPSL audits and also marine transportation and other complex audits. The division needs additional audit resources to perform the backlog of NPSL audits and to allow the audit staff to remain current on the other audits.

**Why is this Project Needed Now?:**

The division needs to engage outside contract auditors now to catch up on its NPSL audits and to allow existing audit staff to continue performing other oil and gas audits. The impacts of not funding outside contract auditors could be

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decreased state revenues from audit recoveries, and the failure to detect noncompliance in oil and gas royalty and net profit share lease payments and reporting by oil and gas producers. As an example of the amounts at issue in NPSL audits, the division recovered approximately \$18.4 million in the most recent NPSL audit completed. The division is unlikely to complete NPSL audits in a timely manner, or to collect audit claims, during fiscal year 2009 without additional audit resources in the form of outside contract auditors.

**Specific Spending Detail:**

LINE ITEM	DOLLAR AMOUNT	DESCRIPTION (text)
Services	\$ 200,000	Funding under this CIP will pay for outside contract auditors to perform profit share lease audits and issue audit claims.

**Project Support:**

Supporters will include Alaskans who benefit from increased state revenues from oil and gas production and the Alaska Permanent Fund (which receives a portion of oil and gas royalties).

**Project Opposition:**

Opponents may include groups opposed to state spending and possibly oil and gas producers. However, oil and gas producers may support the project as they have an interest in timely audits to reduce their contingent liabilities relating to future audit claims and also to reduce interest expense incurred on audit claims.