REPORT OF

THE

STATE AUDITOR

Severance Tax Direct Distribution Payments
Department of Local Affairs

Performance Audit
August 2007

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STATE OF COLORADO

Sally Symanski, CPA
State Auditor

OFFICE OF THE STATE AUDITOR
303.869.2800
FAX 303.869.3060

Legislative Services Building
200 East 14th Avenue
Denver, Colorado 80203-2211

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Members of the Legislative Audit Committee:

This report contains the results of our review of the Department of Local Affairs' (DOLA's) severance tax direct distribution methodology, which returns a portion of these revenues to counties and municipalities on the basis of production employee residence. Our review of this issue was part of an ongoing performance audit of DOLA's distribution of state severance tax and federal mineral lease revenues. The audit is being conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government.

Audit work described in this report was performed from January through July of 2007 and conducted in accordance with generally accepted government auditing standards. We reviewed statutes, analyzed direct distribution payment data, and conducted interviews with program management and staff, stakeholder groups, and local governments. We acknowledge the efforts and assistance extended by DOLA management and staff during our review. This report presents our findings and conclusions, a recommendation related to the severance tax direct distribution, and the response of the Department of Local Affairs. The audit findings related to DOLA's energy and mineral impact assistance grants will be released in a separate report in the fall of 2007.

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Severance Tax Direct Distributions

Background

Severance taxes are a special excise tax imposed upon nonrenewable natural resources that are removed from the earth. Severance taxes are intended to recapture a portion of the wealth that is irretrievably lost when these resources are removed and sold for private profit. Five natural resources are subject to Colorado's severance tax: oil and gas, coal, metallic minerals, molybdenum ore, and oil shale. Metallic minerals include such things as gold, silver, copper, nacholite, uranium, vanadium, and zinc. The severance tax applies regardless of whether the resources are removed from privately or publicly owned lands, and the tax rate is set differently depending on the type of resource being extracted. The severance tax on oil and gas, metallic minerals, and oil shale is based on the gross income derived from the sale of these commodities, whereas the severance tax on coal and molybdenum is based on the weight of the mineral that is extracted. Currently the majority of severance tax revenues collected by the State are from oil and gas production. During Fiscal Year 2006 the State collected severance tax revenues totaling approximately $221.3 million, of which about $211.2 million (95 percent) was from severance taxes levied on oil and gas.

The original statutes creating the severance tax [Title 39, Article 29] were enacted 30 years ago in 1977. At that time, the General Assembly expressed its intent that a portion of severance tax revenues be made available to local governments to offset the impacts created by nonrenewable resource development. State statute [Section 39-29-108(2), C.R.S.] requires that 50 percent of all severance tax revenues be credited to the Local Government Severance Tax Fund (Fund) for distribution by DOLA's Executive Director. Over the years, the statute governing the administration and use of the Fund [Section 39-29-110, C.R.S.], including how monies are distributed to local governments, has been amended a number of times.

The table on the next page shows the total Fund revenues for Fiscal Years 2002 through 2006. The majority of revenues come from severance tax receipts. However, interest income is also earned on the Fund's cash balance and on loans from the Fund, which are allowed under statute. With the exception of a decline in Fiscal Year 2003, Fund revenues have increased significantly over the last several years. In Fiscal Year 2006, Fund revenues totaled about $116.2 million, an increase of more than 300 percent over Fiscal Year 2002 revenues. According to DOLA staff, preliminary figures show a decrease in severance tax revenues for Fiscal Year 2007.

Department of Local Affairs
Local Government Severance Tax Fund Revenues[1]
Fiscal Years 2002 Through 2006

	Fiscal Year					% Change 2002-2006
	2002	2003	2004	2005	2006	
Severance Taxes	$25,275,000	$13,109,000	$59,562,000	$71,692,000	$110,667,000	+338%
Interest Income	$3,221,000	$2,770,000	$1,970,000	$3,457,000	$5,475,000	+70%
Other[2]	$57,000	$80,000	$82,000	$17,000	$34,000	-40%
Total	**$28,553,000**	**$15,959,000**	**$61,614,000**	**$75,166,000**	**$116,176,000**	**307%**

Source: Colorado Financial Reporting System. Figures are rounded to the nearest thousand dollars.
[1]Revenues are shown here on an accrual basis.
[2]Includes penalty assessments, accounts payable reversions, and reimbursements for prior year expenditures.

Direct Distribution Payments

For periods prior to Fiscal Year 2008, state statute [Section 39-29-110(1)(c), C.R.S.] directs DOLA's Executive Director to distribute 15 percent of the severance tax receipts and other income credited to the Local Government Severance Tax Fund directly to counties and municipalities where energy and mineral production employees reside. Starting with Fiscal Year 2008, the percentage of Fund revenues to be distributed via this "direct distribution" increases to 30 percent pursuant to House Bill 07-1139. DOLA distributes the remaining Fund revenues through a competitive grant process. Our findings and recommendations related to these energy and mineral impact assistance grants will be released under separate cover in the fall of 2007.

During our audit we reviewed the severance tax direct distribution process to determine whether DOLA's implementation of the direct distribution complied with the statutes. We also requested a legal opinion from the Office of Legislative Legal Services (OLLS) to gain additional perspective regarding the intent of the statutory provisions and to determine whether DOLA's methodology was a reasonable implementation. According to the OLLS opinion, DOLA's methodology for calculating the direct distribution payments is reasonable given the complexity and ambiguity of the direct distribution statute [Section 39-29-110(1)(c), C.R.S.] and other provisions outlined in Title 39, Article 29. However, as we describe in the following sections, we found that DOLA's methodology also raises questions about whether the intents of the direct distribution statutes are being achieved. Because of these results, as well as the complexity of the statutes, we concluded that DOLA needs to work with the General Assembly and other stakeholders to reevaluate and clarify the statutory intent and goals of the direct distribution and better align the payment calculation methodology to ensure outcomes consistent with these goals.

Distribution Methodology

The direct distribution of severance tax revenues to local governments is based on a formula and reporting requirements set in state statute. First, Section 39-29-110(1)(c), C.R.S., requires DOLA's Executive Director to make direct distribution payments "to counties or municipalities on the basis of the proportion of employees of the mine or related facility or crude oil, natural gas, or oil and gas operation who reside in any such county's unincorporated area or in any such municipality to the total number of employees of the mine or related facility or crude oil, natural gas, or oil and gas operation." Only counties or municipalities with production employees residing within their boundaries are eligible to receive direct distribution payments. If a production employee resides within an incorporated area, the direct distribution payment is made to the municipality. If a production employee resides within an unincorporated area, the direct distribution payment is made to the county.

Second, Section 39-29-110(1)(d), C.R.S., outlines the requirements for counting and reporting production employees. Ninety days prior to the end of each fiscal year (i.e., by March 31), the Department of Revenue (DOR) sends every producer of oil and gas, coal, metallic minerals, molybdenum ore, or oil shale an employee residence reporting form. Producers are required to report their name and address; the name of the mine, related facility, or oil and gas operation; and where each production employee maintains his or her actual residence as given by the employee. Producers must submit their completed employee residence reports to DOR by April 30 each year, and DOR transmits the completed reports to DOLA. DOLA then uses these reports to calculate the total number of production employees residing in each municipality or unincorporated county area. When this subsection of statute was created, only producers who actually remitted severance taxes were required to complete the employee residence report. However, in 1999 and 2000 some of the severance tax statutes [Sections 39-29-103 through 106, C.R.S.] were amended to require all producers to complete the employee residence report, regardless of whether the producer actually pays any severance taxes.

The statute requires DOLA to make the direct distribution payments to local governments no later than August 31 each year. On average, 128 municipalities and 39 counties receive direct distribution payments annually. The table on the next page shows a breakdown of the direct distribution payments to counties and municipalities and the production employee counts for Fiscal Years 2002 through 2006. Direct distribution payments during this five-year period totaled approximately $43.6 million—about $28.2 million (65 percent) was paid to municipalities and about $15.4 million (35 percent) was paid to counties. On average, about 5,000 production employees were reported annually between Fiscal Year 2002 and Fiscal Year 2006. The total production employee count increased by about 58 percent over this five-year period.

Department of Local Affairs
Severance Tax Direct Distribution Payments[1] and Production Employee Counts
Fiscal Years 2002 Through 2006
(Dollars In Millions)

	Fiscal Year					**5-Year Total**
	2002	**2003**	**2004**	**2005**	**2006**	
Counties						
Payments	$1.2	$0.7	$1.5	$4.3	$7.7	$15.4
Employee Count	979	1,244	985	1,526	3,043	
Municipalities						
Payments	$3.1	$1.7	$7.2	$7.2	$9.0	$28.2
Employee Count	3,297	3,624	4,249	2,526	3,694	
Statewide						
Payments	**$4.3**	**$2.4**	**$8.7**	**$11.5**	**$16.7**	**$43.6**
Employee Count	**4,276**	**4,868**	**5,234**	**4,052**	**6,737**	

Source: Severance Tax Direct Distribution data provided by the Department of Local Affairs.
[1]The direct distribution payments are calculated using severance tax revenues on a cash basis.

Statutory Intent

The direct distribution methodology as outlined in state statute has two intents. First, Section 39-29-101(3), C.R.S., states that it is the intent of the General Assembly that "a portion [of severance tax revenues] be made available to local governments to offset the impact created by nonrenewable resource development" [emphasis added]. This is accomplished in the direct distribution methodology specified in Section 39-29-110(1)(c), C.R.S., by requiring that payments be made to counties or municipalities where production employees reside. Statutory provisions in this article, as well as program guidance issued by DOLA, make it clear that counties and municipalities receive distributions for all production employees who live in their jurisdictions, regardless of whether the employees' producers paid any severance taxes. By making payments to jurisdictions where production employees live, the direct distribution acknowledges that these communities are impacted by the additional burdens placed on roads, housing, water and sewer systems, public safety, and other infrastructure and government services resulting from active energy and mineral resource development. Recent legislative debate surrounding the passage of House Bill 07-1139, which increased the percentage of funds allocated through the direct distribution, further emphasizes that the intent of the direct distribution is to help local communities deal with the impacts of active energy and mineral development on their infrastructure and services.

Second, according to OLLS, another intent of the direct distribution is to account for differences in the amount of revenue production among producers. As discussed previously, Section 39-29-110(1)(c), C.R.S., states that the distribution shall be made "to counties or municipalities on the basis of the proportion of employees <u>of the mine or related facility or crude oil, natural gas, or oil and gas operation</u> who reside in any such county's unincorporated area or in any such municipality to the total number of employees <u>of the mine or related facility or crude oil, natural gas, or oil and gas operation</u>" [emphasis added]. In its opinion, OLLS stated that a plain reading of this language suggests DOLA should calculate payments to local governments using revenues generated and number of production employees on a facility-by-facility or operation-by-operation basis. In other words, 15 percent (or 30 percent starting in Fiscal Year 2008) of the severance tax revenues generated by each facility or crude oil, natural gas, or oil and gas operation should be returned to counties and municipalities in which that facility's or operation's employees reside. Implicit in this plain reading is the intent that direct distribution payments to counties and municipalities *be proportional to* the amount of severance tax revenues generated by the production employees residing in these jurisdictions. Therefore, communities with production employees who generate a larger percentage of the severance tax revenues should receive a larger share of the direct distribution payments.

While acknowledging the plain reading of the direct distribution statutes, OLLS also stated that when interpreting a statute it must be presumed that "a result feasible of execution is intended" [Section 2-4-201(1)(d), C.R.S.]. Implementing this plain reading of the direct distribution statute is problematic for a couple of reasons. First, the data that would enable DOLA to identify the severance tax revenues paid by each facility or crude oil, natural gas, or oil and gas operation are not currently available. Second, even if all pertinent data were available, this approach would result in a per-employee payment rate specific to each facility or operation, which could be cumbersome to administer.

Because of the problems with calculating the direct distribution payments on a facility-by-facility or operation-by-operation basis, DOLA instead calculates the direct distribution payments to local governments on an industry-by-industry basis. OLLS determined that this approach is a reasonable proxy and one that is "more feasible of execution." Specifically, DOLA separates severance tax revenues and production employees by industry and calculates three different statewide per-employee payment rates: one for coal employees, one for metals employees, and one for oil and gas employees. DOLA then multiplies the statewide industry-specific per-employee payment rate by the number of employees working in that industry who reside in each county and municipality. According to DOLA staff, the direct distribution calculation has always been performed in this manner. The current methodology acknowledges that each industry and its production employees do not contribute equally to the total severance tax revenue collected by the State.

The following table illustrates the statewide industry-specific per-employee payment rates DOLA applied in the Fiscal Year 2006 severance tax direct distribution. As an example of how the payments are calculated, a municipality with four coal employees and six oil and gas employees residing in its jurisdiction received a Fiscal Year 2006 direct distribution payment totaling $22,588 [(4 × $481) + (6 × $3,444)].

Department of Local Affairs
Severance Tax Direct Distribution
Statewide Production Employee Payment Rates by Industry Type
Fiscal Year 2006

Industry Type	Severance Tax Revenues	Number of Production Employees	Calculated Payment Rate
Coal	$860,105	1,788	$481
Metals[1]	$159,963	397	$403
Oil & Gas	$15,675,912	4,552	$3,444
Total	**$16,695,980**	**6,737**	

Source: Severance Tax Direct Distribution data provided by the Department of Local Affairs.
[1]Includes producers subject to the severance tax on molybdenum and the severance tax on metallic minerals (e.g., gold, silver, copper, uranium).

It is important to note that the direct distribution methodology does not return revenues to counties and municipalities where the production occurred unless production employees live in that same jurisdiction. However, *ad valorem* taxes assessed at the county level provide a source of revenue to jurisdictions where the production occurs. For example, county assessors' valuation of oil and gas lands is based on a percentage of the sale price obtained for the mineral produced at the wellhead location being taxed.

Impact of Employee Residence

With respect to the first intent of the direct distribution, which is to acknowledge the impact on communities from the production employees who reside in their jurisdictions, our audit found that the current payment methodology results in local governments receiving significantly more money for the oil and gas employees who reside in their jurisdictions than for coal or metals employees. Consequently, although the number of production employees residing in different counties or municipalities may be similar, local governments may receive widely disparate direct distribution payments depending on the industry mix of production employees residing in their jurisdictions.

The table below shows three municipalities, each with very similar total production employee counts. Town A, City B, and Town C each had about 60 to 70 production employees residing in their jurisdictions but received a substantially different Fiscal Year 2006 direct distribution payment because of the differing number of production employees in different industries. For example, City B, which had mostly oil and gas employees, received a payment more than four-and-a-half times higher than the payment to Town C, which had mostly coal employees. It is not reasonable to assume that oil and gas employees use community infrastructure and services at a substantially higher rate than coal or metals employees. If the intent of the direct distribution statute is to acknowledge the impact on local communities from production employees who are residing in their jurisdictions, then the current practice of paying counties and municipalities at a different rate for oil and gas, coal, and metals employees appears problematic.

Department of Local Affairs
Employee Counts and Direct Distribution Payments to Selected Jurisdictions
Fiscal Year 2006

	Number of Coal Employees	Number of Metals Employees	Number of Oil & Gas Employees	Total Production Employees	Total Distribution Payment
Town A	37	12	20	69	$91,509
City B	0	1	65	66	$224,246
Town C	57	0	6	63	$48,082

Source: Severance Tax Direct Distribution data provided by the Department of Local Affairs.

Proportion of Revenues Generated

With respect to the second intent of the direct distribution, which is to acknowledge differences in revenue generation by making payments in proportion to the total revenues generated by the production employees who are residing in each county or municipality, our audit found that the current payment methodology results in wide disparities between each region's share of the direct distribution payments and its estimated contributions to total severance tax revenues. We compared data on direct distribution payments for Fiscal Years 2002 through 2006 with DOLA's estimates of severance tax revenues generated for the same five-year period on a regional basis. We used a regional approach because although production employees may not reside in the same county as where the severance tax revenues are generated, production employees are likely to live in the same region. (See Appendix A for a map of the regions used.)

As shown in the table below, counties and municipalities in the Southwest received about 10 percent of the direct distribution payments during Fiscal Years 2002 through 2006, yet energy and mineral production in the Southwest was estimated to have contributed about 52 percent of the State's total severance tax revenues over the same period. Conversely, counties and municipalities in the Northwest received about 59 percent of the direct distribution payments, yet energy and mineral production in the Northwest was estimated to have contributed about 33 percent of the State's total severance tax revenues.

Department of Local Affairs
Percentage of Direct Distribution Payments Received
Versus Severance Tax Revenues Generated
Fiscal Years 2002 Through 2006

Region[1]	Average Number of Production Employees in Residence as a Percentage of Total Employees Statewide	Direct Distribution Payments Received as a Percentage of Total Payments	Estimated Contributions to Severance Tax Revenues as a Percentage of Total Revenues[2]
Eastern Plains	4%	7%	2%
Front Range	17%	16%	4%
Northwest	53%	59%	33%
Southern Mountain	6%	8%	9%
Southwest	20%	10%	52%
Statewide	**100% 5,036 employees**	**100% $43.6 million**	**100% $563.5 million**

Source: Office of the State Auditor's analysis of data provided by the Department of Local Affairs.
[1]Counties included in each region can be found in Appendix A.
[2]The Department of Revenue only maintains severance tax data at the taxpayer (i.e., producer) level. Consequently, DOLA uses an econometric model to estimate the amount of severance tax revenues contributed by energy and mineral production in each county.

Additionally, as shown in the following table, the disparities among regions are apparent on a per-production employee basis. On a statewide basis, direct distribution payments averaged about $8,700 per production employee, and severance tax revenues generated averaged about $8,400 per production employee. However, each production employee in the Southwest region contributed an average of about $22,200 to the severance tax revenues during Fiscal Years 2002 through 2006, yet counties and municipalities in the Southwest region received direct distribution payments of about $4,500 per production employee over this period. In contrast, each production employee in the Front Range region contributed an average of about $1,900 to the severance tax revenues, yet counties and municipalities in the Front Range region received direct distribution payments of about $8,000 per production employee. In this analysis, we applied the same per-employee rate for all production employees residing within each region regardless of industry.

Department of Local Affairs
Direct Distribution Payments Received Versus
Severance Tax Revenues Generated Per Production Employee
Fiscal Years 2002 Through 2006

Region[1]	**Average Number of Production Employees in Residence**	**Total Direct Distribution Payments Received Per Production Employee**	**Estimated Severance Tax Contributions Per Production Employee[2]**
Eastern Plains	209	$14,354	$3,732
Front Range	873	$8,018	$1,864
Northwest	2,660	$9,737	$5,160
Southern Mountain	293	$10,922	$13,387
Southwest	1,001	$4,496	$22,185
Statewide	**5,036 employees**	**$8,658**	**$8,392**

Source: Office of the State Auditor's analysis of data provided by the Department of Local Affairs.
[1]Counties included in each region can be found in Appendix A.
[2]The Department of Revenue only maintains severance tax data at the taxpayer (i.e., producer) level. Consequently, DOLA uses an econometric model to estimate the amount of severance tax revenues contributed by energy and mineral production in each county.

There are several factors contributing to the disproportionate relationship between revenues generated and severance tax distributions by region. First, not all areas of the State are equally productive. DOLA reported that the productivity and maturity of the mineral and oil and gas fields, as well as the labor-efficiency of the energy and mineral production methods required to extract these mineral and oil and gas deposits, vary considerably across the State. As a result, production in some areas, such as the Southwest, generates higher yields and revenues using fewer employees, whereas production in other areas, such as the Northwest, generates relatively lower yields and revenues using more employees. Second, all producers are required to report production employee counts, regardless of whether the producer actually paid any severance taxes. Thus, counties and municipalities receive payments for production employees residing in their jurisdictions even when those production employees do not "contribute" to severance tax revenues collected by the State. Further, DOLA reported that some jurisdictions are more proactive than others at ensuring that producers in their area complete and return employee residence reports to the State. Therefore, DOLA's information on total production employees by region may not be complete. Finally, DOLA calculates the industry-specific per-employee payment rates on a statewide basis, which smoothes out the regional differences in productivity. Consequently, the current methodology is driven less by the proportion of revenues generated and more by where production employees live.

Alternatives

Our analysis has shown that DOLA's current distribution methodology, although reasonable given the complexity and ambiguity of the statutes, raises questions about whether the intents of the direct distribution statutes are being achieved. In practice, it is not possible to fully achieve both intents of the direct distribution statutes simultaneously. Resolving these issues will require a determination of which statutory intent takes precedence and what the desired outcomes are. This is particularly important, since outcomes and disparities will be further amplified when the portion of monies allocated to local governments doubles from 15 percent to 30 percent of Local Government Severance Tax Fund revenues for the Fiscal Year 2008 distribution.

If addressing impact is important (i.e., returning monies to areas where production employees reside), an alternative approach would be to treat each production employee equally when calculating the severance tax direct distribution payments. Using available data from the Fiscal Year 2006 severance tax direct distribution, we calculated a single statewide per-employee payment rate to determine the effect that treating production employees as a single pool would have on direct distribution payments to counties and municipalities. As expected, normalizing the payment rate had the largest effect on payments to jurisdictions with predominantly only one type of production employee. That is, communities with predominantly oil and gas employees saw the largest reductions in payments, and communities with predominantly coal and metals employees saw the largest increases in payments. (The results of our analysis for all counties and municipalities receiving direct distribution payments in Fiscal Year 2006 are in Appendix B.)

If accounting for differences in revenue generation is important (i.e., making payments in proportion to the total revenues generated by the production employees residing in each county or municipality), this cannot be accomplished using statewide per-employee payment rates. DOLA will need to develop a payment calculation methodology that accounts for the proportion of revenues generated by production employees residing in each jurisdiction. Potentially, DOLA will need to obtain actual data on severance tax revenues at the county level. These data are not currently available and, according to DOLA staff, could be difficult to collect since a single severance taxpayer may have active production across multiple counties.

Additionally, other approaches could be developed to more effectively promote both of the intents of the direct distribution. For example, a percentage of the direct distribution payment could be based on employee residence regardless of industry type, and the remaining percentage of the direct distribution payment could be based on the proportion of severance tax revenues generated. The direct distribution methodology could also be expanded to include components that take into account additional factors, such as jurisdictions where energy and mineral production occurs, or new exploration and production.

We obtained information on severance tax distribution practices in other states from a 2006 report prepared by the National Conference of State Legislatures (NCSL). According to the NCSL report, Colorado is 1 of 15 states that distribute a portion of severance tax revenues to local governments. We were able to obtain some information on distribution methodologies in 10 of these other states (Florida, Kansas, Kentucky, Louisiana, Mississippi, North Dakota, Oklahoma, South Dakota, Tennessee, and West Virginia). We found that, in general, these 10 states distribute severance tax revenues to counties and municipalities on the basis of factors such as the location of production, the total production volume, or the proportion of tax revenues generated. For example, Kansas distributes a portion of its severance tax revenues to counties in proportion to the amount of the taxes levied, with half going to the county and half going to school districts within the county. Oklahoma distributes a portion of its severance tax revenues to each county's highway fund in proportion to the total value of production from each county in the preceding year. North Dakota distributes a portion of its severance tax revenues from coal to counties, including municipalities and school districts within these counties, in proportion to the number of metric tons of coal severed at each mining operation. North Dakota has additional provisions to split revenues between coal-producing counties and adjoining non-coal-producing counties when the coal mining operation is within 15 miles of the county line. We found that none of these 10 other states considers production employee residence when distributing funds, as is the current practice in Colorado.

During the 2007 Legislative Session, Senate Joint Resolution 07-042 created an Interim Committee and a Working Group to study the allocation of severance tax and federal mineral lease revenues in Colorado. DOLA's Executive Director is a member of the Working Group, and the General Assembly called for DOLA to work closely with the Interim Committee and the Working Group to provide pertinent data, information, and resources. The direct distribution methodology is a sensitive issue because any substantial change will affect payment amounts to local governments and result in winners and losers. We believe that the Interim Committee and Working Group provide DOLA with an appropriate forum and ideal opportunity to initiate discussions with policymakers and stakeholders regarding the purpose and intent of the direct distribution and to seek appropriate solutions to the issues raised by our review.

Recommendation No. 1:

The Department of Local Affairs should work with the General Assembly and relevant stakeholder groups to reevaluate and clarify the statutes governing the severance tax direct distribution payments to counties and municipalities by:

a. Clearly specifying the intent and goals of the severance tax direct distribution.

b. Aligning the payment calculation methodology to distribute funds in accordance with legislative intent and goals.

c. Seeking statutory change as appropriate.

Department of Local Affairs Response:

Agree. Implementation date: May 2008.

The Department of Local Affairs (DOLA) agrees to work with the General Assembly and relevant stakeholder groups to implement Recommendation No. 1. At the pleasure of legislative leadership, this could occur through the ongoing work of the Interim Committee to Study the Allocation of Severance Tax and Federal Mineral Leasing Revenues, or in another manner as specified by leadership.

Although the audit determined DOLA's methodology for calculating the direct distributions is a reasonable implementation of statute, the Department concurs that related statutes are complex and somewhat ambiguous, as noted in the audit. Therefore, DOLA commits to work with the General Assembly and stakeholders to arrive at understandable and commonly agreed-upon interpretations of the intent and goals of the direct distribution program.

Once agreement on such interpretations is achieved and statutes are modified by enacted law, the payment calculation methodology can be realigned accordingly.

Statutory changes could be achieved in the 2008 session of the General Assembly. Implementation of program changes by DOLA will begin immediately upon such changes becoming law. Annual direct distributions will be made in accordance with the operative statutes.

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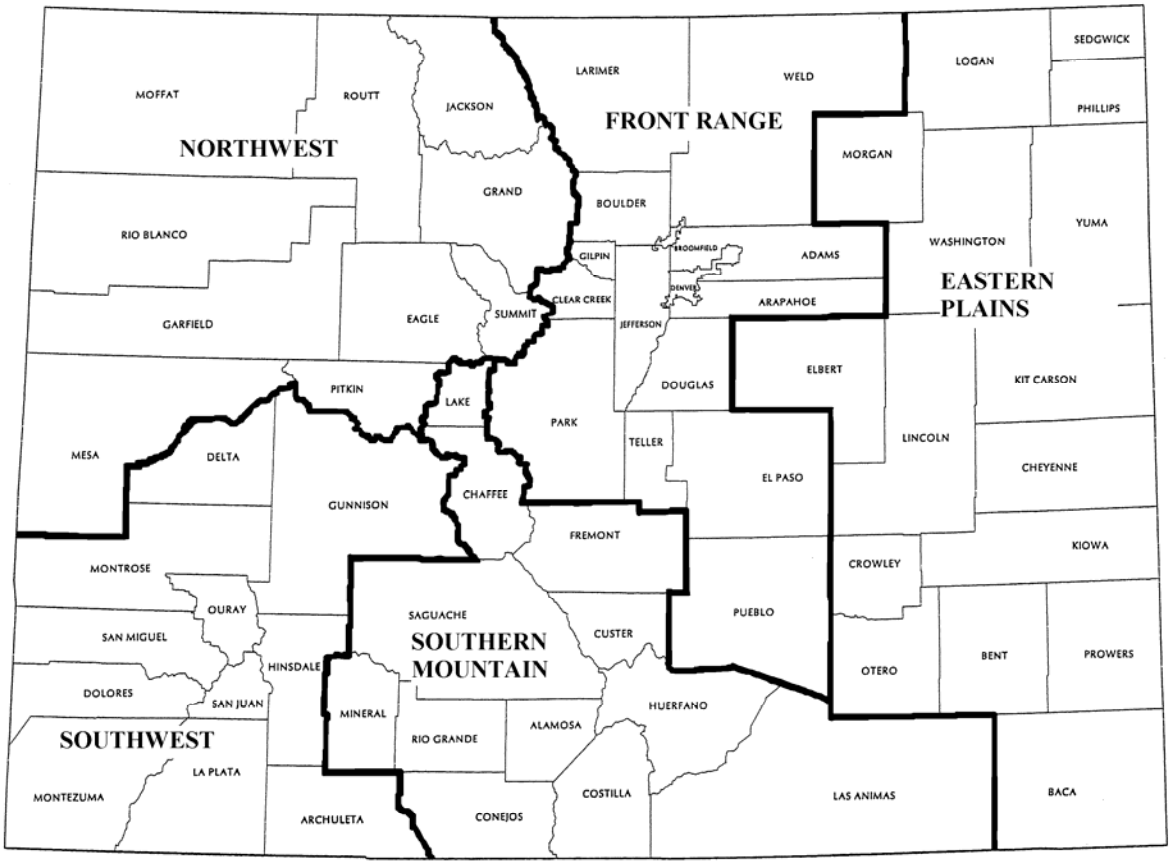
Appendix A
Colorado Counties by Region



Eastern Plains: Baca, Bent, Cheyenne, Crowley, Elbert, Kiowa, Kit Carson, Lincoln, Logan, Morgan, Otero, Phillips, Prowers, Sedwick, Washington, and Yuma Counties.

Front Range: Adams, Arapahoe, Boulder, Broomfield, Clear Creek, Denver, Douglas, El Paso, Gilpin, Jefferson, Larimer, Park, Pueblo, Teller, and Weld Counties.

Northwest: Eagle, Garfield, Grand, Jackson, Mesa, Moffat, Pitkin, Rio Blanco, Routt, and Summit Counties.

Southern Mountain: Alamosa, Chaffee, Conejos, Costilla, Custer, Fremont, Huerfano, Lake, Las Animas, Mineral, Rio Grande, and Saguache Counties.

Southwest: Archuleta, Delta, Dolores, Gunnison, Hinsdale, La Plata, Montezuma, Montrose, Ouray, San Juan, and San Miguel Counties.

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Appendix B

Note: Severance tax direct distribution payments to counties and municipalities under Section 39-29-110(1)(c), C.R.S., are currently calculated using industry-specific per-employee payment rates. Data in the following table show production employee counts by industry and in total for each jurisdiction, along with the jurisdiction's actual Fiscal Year 2006 direct distribution payment. The last column shows the estimated change in this direct distribution payment if a single statewide per-employee payment rate were used.

Appendix B
Department of Local Affairs
Actual Severance Tax Direct Distribution Payments Using Industry-Specific Per-Employee Payment Rates and Estimated Changes in Payments Using a Single Per-Employee Payment Rate
Fiscal Year 2006

Jurisdiction	Production Employees				Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
	Coal	Metals	Oil & Gas	Total		
Adams County						
Adams County	0	0	11	11	$37,881	($10,600)
Arvada, City of	0	5	6	11	$22,677	$4,600
Bennett, Town of	0	0	5	5	$17,219	($4,800)
Brighton, City of	0	0	39	39	$134,306	($37,600)
Commerce City, City of	0	1	5	6	$17,622	($2,700)
Northglenn, City of	0	0	4	4	$13,775	($3,900)
Thornton, City of	0	3	14	17	$49,421	($7,300)
Westminster, City of	0	4	4	8	$15,387	$4,400
Arapahoe County						
Arapahoe County	0	0	5	5	$17,219	($4,800)
Aurora, City of	0	0	10	10	$34,437	($9,700)
Centennial, City of	0	0	5	5	$17,219	($4,800)
Deer Trail, Town of	0	0	3	3	$10,331	($2,900)
Englewood, City of	0	3	4	7	$14,984	$2,400
Greenwood Village, City of	0	0	1	1	$3,444	($1,000)
Littleton, City of	0	2	6	8	$21,468	($1,600)
Archuleta County						
Archuleta County	0	0	2	2	$6,887	($1,900)
Pagosa Springs, Town of	0	0	2	2	$6,887	($1,900)
Baca County						
Springfield, Town of	0	0	2	2	$6,887	($1,900)
Walsh, Town of	0	0	1	1	$3,444	($1,000)
Bent County						
Las Animas, City of	0	0	2	2	$6,887	($1,900)

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Department of Local Affairs
Actual Severance Tax Direct Distribution Payments Using Industry-Specific Per-Employee Payment Rates and Estimated Changes in Payments Using a Single Per-Employee Payment Rate
Fiscal Year 2006

Jurisdiction	Production Employees: Coal	Metals	Oil & Gas	Total	Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
Boulder County						
Boulder, City of	0	0	3	3	$10,331	($2,900)
Longmont, City of	0	1	12	13	$41,728	($9,500)
Lyons, Town of	0	0	2	2	$6,887	($1,900)
Nederland, Town of	0	2	0	2	$806	$4,200
Broomfield County						
Broomfield, City and County of	0	2	4	6	$14,581	$300
Chaffee County						
Buena Vista, Town of	0	2	1	3	$4,250	$3,200
Salida, City of	0	0	1	1	$3,444	($1,000)
Cheyenne County						
Cheyenne County	0	0	8	8	$27,550	($7,700)
Cheyenne Wells, Town of	0	0	14	14	$48,212	($13,500)
Kit Carson, Town of	0	0	6	6	$20,662	($5,800)
Clear Creek County						
Clear Creek County	0	5	0	5	$2,015	$10,400
Empire, Town of	0	6	0	6	$2,418	$12,500
Georgetown, Town of	0	10	0	10	$4,029	$20,800
Idaho Springs, City of	0	20	0	20	$8,059	$41,500
Conejos County						
Antonito, Town of	0	0	1	1	$3,444	($1,000)
Costilla County						
Costilla County	0	1	0	1	$403	$2,100
Crowley County						
Crowley County	0	0	1	1	$3,444	($1,000)
Ordway, Town of	0	1	0	1	$403	$2,100
Delta County						
Cedaredge, Town of	25	0	1	26	$15,470	$49,000
Crawford, Town of	19	0	3	22	$19,471	$35,100
Delta County	445	0	11	456	$251,945	$878,300
Delta, City of	125	0	12	137	$101,455	$238,100

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Jurisdiction	Production Employees				Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
	Coal	Metals	Oil & Gas	Total		
Hotchkiss, Town of	40	0	2	42	$26,129	$78,000
Orchard City, Town of	57	0	6	63	$48,082	$108,100
Paonia, Town of	100	0	2	102	$54,992	$197,800
Denver County						
Denver, City and County of	0	2	31	33	$107,562	($25,800)
Dolores County						
Dolores County	0	0	1	1	$3,444	($1,000)
Dove Creek, Town of	0	0	12	12	$41,325	($11,600)
Douglas County						
Castle Rock, Town of	0	0	2	2	$6,887	($1,900)
Douglas County	0	1	6	7	$21,065	($3,700)
Lone Tree, City of	0	0	2	2	$6,887	($1,900)
Parker, Town of	0	2	4	6	$14,581	$300
Eagle County						
Avon, Town of	0	0	1	1	$3,444	($1,000)
Basalt, Town of	0	0	1	1	$3,444	($1,000)
Eagle County	0	0	3	3	$10,331	($2,900)
Gypsum, Town of	0	0	1	1	$3,444	($1,000)
El Paso County						
Colorado Springs, City of	1	13	12	26	$47,044	$17,400
El Paso County	0	0	3	3	$10,331	($2,900)
Fountain, City of	0	0	2	2	$6,887	($1,900)
Green Mountain Falls, Town of	0	0	1	1	$3,444	($1,000)
Manitou Springs, City of	0	1	0	1	$403	$2,100
Elbert County						
Elbert County	0	1	2	3	$7,290	$100
Kiowa, Town of	0	0	2	2	$6,887	($1,900)
Fremont County						
Canon City, City of	0	40	6	46	$36,780	$77,200
Coal Creek, Town of	0	1	0	1	$403	$2,100
Florence, City of	0	0	1	1	$3,444	($1,000)
Fremont County	0	30	4	34	$25,863	$58,400

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Actual Severance Tax Direct Distribution Payments Using Industry-Specific Per-Employee Payment Rates and Estimated Changes in Payments Using a Single Per-Employee Payment Rate
Fiscal Year 2006

	Production Employees				Actual Direct	Estimated
Jurisdiction	**Coal**	**Metals**	**Oil & Gas**	**Total**	**Distribution Payment[1]**	**Change in Payment[2]**
Rockvale, Town of	0	1	2	3	$7,290	$100
Williamsburg, Town of	0	1	1	2	$3,847	$1,100
Garfield County						
Carbondale, Town of	1	0	0	1	$481	$2,000
Garfield County	2	7	699	708	$2,410,958	($656,100)
Glenwood Springs, City of	1	0	12	13	$41,806	($9,600)
New Castle, Town of	0	0	14	14	$48,212	($13,500)
Parachute, Town of	0	0	171	171	$588,880	($165,000)
Rifle, City of	1	1	167	169	$575,989	($157,100)
Silt, Town of	0	0	28	28	$96,425	($27,000)
Grand County						
Fraser, Town of	0	1	0	1	$403	$2,100
Granby, Town of	0	2	0	2	$806	$4,200
Grand County	0	2	0	2	$806	$4,200
Hot Sulphur Springs, Town of	0	5	0	5	$2,015	$10,400
Kremmling, Town of	0	8	0	8	$3,223	$16,600
Gunnison County						
Gunnison County	12	0	0	12	$5,773	$24,000
Gunnison, City of	0	0	1	1	$3,444	($1,000)
Hinsdale County						
Lake City, Town of	0	5	0	5	$2,015	$10,400
Huerfano County						
Huerfano County	0	0	3	3	$10,331	($2,900)
La Veta, Town of	0	0	3	3	$10,331	($2,900)
Walsenburg, City of	0	0	13	13	$44,769	($12,500)
Jackson County						
Jackson County	1	0	1	2	$3,925	$1,000
Walden, Town of	0	0	4	4	$13,775	($3,900)
Jefferson County						
Edgewater, City of	0	0	2	2	$6,887	($1,900)
Golden, City of	0	7	0	7	$2,821	$14,500
Jefferson County	0	14	15	29	$57,297	$14,600
Lakewood, City of	0	4	3	7	$11,943	$5,400

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Fiscal Year 2006

Jurisdiction	Production Employees				Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
	Coal	Metals	Oil & Gas	Total		
Morrison, Town of	0	0	2	2	$6,887	($1,900)
Kiowa County						
Eads, Town of	0	0	1	1	$3,444	($1,000)
Kiowa County	0	0	2	2	$6,887	($1,900)
Sheridan Lake, Town of	0	0	2	2	$6,887	($1,900)
Kit Carson County						
Burlington, City of	0	0	5	5	$17,219	($4,800)
La Plata County						
Bayfield, Town of	1	0	16	17	$55,581	($13,400)
Durango, City of	11	0	40	51	$143,041	($16,600)
Ignacio, Town of	0	0	4	4	$13,775	($3,900)
La Plata County	3	0	105	108	$363,036	($95,300)
Lake County						
Lake County	0	2	0	2	$806	$4,200
Leadville, City of	0	3	1	4	$4,653	$5,300
Larimer County						
Berthoud, Town of	0	0	4	4	$13,775	($3,900)
Fort Collins, City of	0	1	7	8	$24,509	($4,700)
Larimer County	0	0	9	9	$30,994	($8,700)
Loveland, City of	0	0	28	28	$96,425	($27,000)
Wellington, Town of	0	0	2	2	$6,887	($1,900)
Las Animas County						
Aguilar, Town of	0	0	14	14	$48,212	($13,500)
Cokedale, Town of	0	0	2	2	$6,887	($1,900)
Las Animas County	0	0	84	84	$289,274	($81,100)
Trinidad, City of	0	0	151	151	$520,005	($145,700)
Lincoln County						
Hugo, Town of	0	0	2	2	$6,887	($1,900)
Limon, Town of	0	0	2	2	$6,887	($1,900)
Logan County						
Fleming, Town of	0	0	1	1	$3,444	($1,000)
Logan County	0	0	12	12	$41,325	($11,600)
Merino, Town of	0	0	3	3	$10,331	($2,900)

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Actual Severance Tax Direct Distribution Payments Using Industry-Specific Per-Employee Payment Rates and Estimated Changes in Payments Using a Single Per-Employee Payment Rate
Fiscal Year 2006

Jurisdiction	Production Employees: Coal	Metals	Oil & Gas	Total	Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
Sterling, City of	0	0	40	40	$137,750	($38,600)
Mesa County						
Collbran, Town of	0	0	8	8	$27,550	($7,700)
De Beque, Town of	0	0	45	45	$154,968	($43,400)
Fruita, City of	3	0	165	168	$569,660	($153,300)
Grand Junction, City of	23	1	507	531	$1,757,444	($441,300)
Mesa County	36	0	853	889	$2,954,829	($751,300)
Palisade, Town of	0	0	33	33	$113,643	($31,800)
Moffat County						
Craig, City of	356	0	20	376	$240,126	$691,800
Dinosaur, Town of	9	0	9	18	$35,323	$9,300
Moffat County	154	0	15	169	$125,737	$293,100
Montezuma County						
Cortez, City of	4	0	6	10	$22,587	$2,200
Dolores, Town of	0	0	4	4	$13,775	($3,900)
Mancos, Town of	2	0	0	2	$962	$4,000
Montezuma County	5	0	18	23	$64,393	($7,400)
Montrose County						
Montrose County	31	0	1	32	$18,356	$61,000
Montrose, City of	15	0	7	22	$31,322	$23,200
Naturita, Town of	6	0	2	8	$9,774	$10,100
Nucla, Town of	13	0	1	14	$9,697	$25,000
Olathe, Town of	5	0	3	8	$12,736	$7,100
Morgan County						
Brush, City of	0	0	5	5	$17,219	($4,800)
Fort Morgan, City of	0	0	33	33	$113,643	($31,800)
Morgan County	0	0	11	11	$37,881	($10,600)
Wiggins, Town of	0	0	7	7	$24,106	($6,800)
Otero County						
Rocky Ford, City of	0	0	1	1	$3,444	($1,000)
Ouray County						
Ouray County	0	1	0	1	$403	$2,100
Ridgway, Town of	0	0	1	1	$3,444	($1,000)

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Fiscal Year 2006

Jurisdiction	Production Employees				Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
	Coal	Metals	Oil & Gas	Total		
Park County						
Park County	0	12	0	12	$4,835	$24,900
Pitkin County						
Aspen, City of	0	1	0	1	$403	$2,100
Pitkin County	0	0	1	1	$3,444	($1,000)
Prowers County						
Holly, Town of	0	0	1	1	$3,444	($1,000)
Lamar, City of	0	0	4	4	$13,775	($3,900)
Prowers County	0	0	1	1	$3,444	($1,000)
Wiley, Town of	0	0	1	1	$3,444	($1,000)
Pueblo County						
Pueblo County	0	0	2	2	$6,887	($1,900)
Pueblo, City of	0	8	4	12	$16,998	$12,700
Rio Blanco County						
Meeker, Town of	37	12	20	69	$91,509	$79,500
Rangely, Town of	53	3	171	227	$615,584	($52,900)
Rio Blanco County	23	11	71	105	$260,002	$300
Rio Grande County						
Del Norte, Town of	0	1	0	1	$403	$2,100
Monte Vista, City of	0	0	3	3	$10,331	($2,900)
Routt County						
Hayden, Town of	39	0	2	41	$25,648	$76,000
Oak Creek, Town of	18	1	1	20	$12,505	$37,100
Routt County	80	0	1	81	$41,927	$158,800
Steamboat Springs, City of	23	0	1	24	$14,508	$45,000
Yampa, Town of	5	0	0	5	$2,405	$10,000
Saguache County						
Center, Town of	0	0	1	1	$3,444	($1,000)
Moffat, Town of	0	0	2	2	$6,887	($1,900)
San Miguel County						
San Miguel County	1	0	0	1	$481	$2,000

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Fiscal Year 2006

Jurisdiction	Production Employees				Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
	Coal	Metals	Oil & Gas	Total		
Summit County						
Breckenridge, Town of	0	0	1	1	$3,444	($1,000)
Dillon, Town of	0	0	1	1	$3,444	($1,000)
Frisco, Town of	0	0	2	2	$6,887	($1,900)
Silverthorne, Town of	0	1	0	1	$403	$2,100
Summit County	0	2	0	2	$806	$4,200
Teller County						
Cripple Creek, City of	0	27	0	27	$10,879	$56,000
Teller County	0	45	0	45	$18,132	$93,400
Victor, City of	0	21	0	21	$8,462	$43,600
Woodland Park, City of	0	24	0	24	$9,670	$49,800
Washington County						
Akron, Town of	0	0	5	5	$17,219	($4,800)
Otis, Town of	1	0	0	1	$481	$2,000
Washington County	0	0	2	2	$6,887	($1,900)
Weld County						
Ault, Town of	0	0	2	2	$6,887	($1,900)
Dacono, City of	0	1	1	2	$3,847	$1,100
Eaton, Town of	0	0	7	7	$24,106	($6,800)
Erie, Town of	0	0	2	2	$6,887	($1,900)
Evans, City of	0	1	65	66	$224,246	($60,700)
Firestone, Town of	0	0	2	2	$6,887	($1,900)
Fort Lupton, City of	0	0	23	23	$79,206	($22,200)
Frederick, Town of	0	0	3	3	$10,331	($2,900)
Garden City, Town of	0	0	3	3	$10,331	($2,900)
Gilcrest, Town of	0	0	6	6	$20,662	($5,800)
Greeley, City of	1	0	128	129	$441,280	($121,500)
Hudson, Town of	0	0	1	1	$3,444	($1,000)
Johnstown, Town of	0	0	11	11	$37,881	($10,600)
Keenesburg, Town of	0	0	9	9	$30,994	($8,700)
Kersey, Town of	0	0	3	3	$10,331	($2,900)
La Salle, Town of	0	0	12	12	$41,325	($11,600)
Lochbuie, Town of	0	0	5	5	$17,219	($4,800)
Milliken, Town of	0	0	10	10	$34,437	($9,700)
Platteville, Town of	0	0	10	10	$34,437	($9,700)

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Actual Severance Tax Direct Distribution Payments Using Industry-Specific Per-Employee Payment Rates and Estimated Changes in Payments Using a Single Per-Employee Payment Rate
Fiscal Year 2006

Jurisdiction	Production Employees				Actual Direct Distribution Payment[1]	Estimated Change in Payment[2]
	Coal	Metals	Oil & Gas	Total		
Severance, Town of	0	0	5	5	$17,219	($4,800)
Weld County	0	1	90	91	$310,340	($84,800)
Windsor, Town of	0	0	6	6	$20,662	($5,800)
Yuma County						
Eckley, Town of	0	0	9	9	$30,994	($8,700)
Wray, City of	0	0	51	51	$175,631	($49,200)
Yuma County	0	0	23	23	$79,206	($22,200)
Yuma, City of	0	0	16	16	$55,100	($15,400)
				Total Payments	**$16.7 million**	

Source: Office of the State Auditor's analysis of Fiscal Year 2006 Severance Tax Direct Distribution Payment data provided by the Department of Local Affairs.
[1]Actual Fiscal Year 2006 direct distribution payment calculated by the Department of Local Affairs using statewide industry-specific per-employee payment rates. Figures are rounded to the nearest dollar.
[2]Estimated change in the Fiscal Year 2006 direct distribution payment calculated by the Office of the State Auditor using a single statewide per-employee payment rate. Figures are rounded to the nearest hundred dollars.

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