Report 04-15
December 2004

An Audit

Petroleum Inspection Fee Revenue Obligations Program

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State Auditor - Janice Mueller

Audit Prepared by

Bryan Naab, Director and Contact Person
Carrie Ferguson

CONTENTS

State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

JANICE MUELLER
STATE AUDITOR

22 E. MIFFLIN ST., STE. 500
MADISON, WISCONSIN 53703
(608) 266-2818
FAX (608) 267-0410
Leg.Audit.Info@legis.state.wi.us

December 14, 2004

Senator Carol A. Roessler and
Representative Suzanne Jeskewitz, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Roessler and Representative Jeskewitz:

At the request of the departments of Commerce and Administration, and to meet our audit responsibilities under s. 13.94, Wis. Stats., we have completed a financial audit of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program for the fiscal years ending June 30, 2004, and June 30, 2003. We were able to express our unqualified opinion on the Statement of Changes in Program Assets and related notes.

Under the Petroleum Inspection Fee Revenue Obligations Program, the State issues revenue obligations, such as bonds and commercial paper, to provide financing for payment of claims under the Wisconsin Petroleum Environmental Cleanup Fund Award (PECFA) program. The obligations are not general obligation debt of the State. Instead, the revenue obligations are to be repaid from the $0.03 per gallon fee charged suppliers for petroleum products sold in Wisconsin and collected by the Department of Revenue.

Between January 2000, when the Petroleum Inspection Fee Revenue Obligations Program was created, and June 30, 2004, the State issued $387.6 million in revenue obligations to pay PECFA claims and to address a backlog of approved but unpaid PECFA claims. The backlog of PECFA claims from prior years has largely been eliminated, and as of June 30, 2004, only $3.9 million in approved claims were awaiting payment and approximately $12.1 million in additional claims had been received but not yet approved for payment. In addition, landowners had incurred an estimated $66.2 million in costs for which reimbursement claims had not yet been submitted.

We appreciate the courtesy and cooperation extended to us during the audit by staff of the departments of Commerce, Administration, and Revenue.

Respectfully submitted,

Janice Mueller

Janice Mueller
State Auditor

JM/BN/ss

Audit Opinion ▪

Independent Auditor's Report on the Statement of Changes in Program Assets of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program

We have audited the accompanying Statement of Changes in Program Assets of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program for the years ended June 30, 2004, and June 30, 2003. This financial statement is the responsibility of the program's management. Our responsibility is to express an opinion on the financial statement based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the Statement of Changes in Program Assets presents only the Petroleum Inspection Fee Revenue Obligations Program and does not purport to, and does not, present fairly the financial position of the State of Wisconsin and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2, to provide a meaningful presentation to bondholders and noteholders regarding resources available to pay debt service, the program's policy is to prepare its financial statement on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the Statement of Changes in Program Assets presents fairly, in all material respects, the Petroleum Inspection Fee Revenue Obligations Program's assets as of June 30, 2004, and June 30, 2003, and the program's receipts and disbursements for the fiscal years then ended, on the cash basis of accounting.

Our audits were conducted for the purpose of forming an opinion on the Statement of Changes in Program Assets of the Petroleum Inspection Fee Revenue Obligations Program. The supplementary information included as Management's Discussion and Analysis on pages 5 through 10 is presented for purposes of additional analysis and is not a required part of the Statement of Changes in Program Assets. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the supplementary information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 6, 2004, on our consideration of the program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

LEGISLATIVE AUDIT BUREAU

December 6, 2004 by Bryan Naab

Bryan Naab
Audit Director

Management's Discussion and Analysis ■

Prepared by Management of the Petroleum Inspection Fee Revenue Obligations Program

Management's Discussion and Analysis (MD&A) is intended to provide users of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program's Statement of Changes in Program Assets with a narrative overview of the statement, as well as an analysis of some key data presented in the statement. The MD&A should be read in conjunction with the accompanying financial statement and notes. The financial statement, notes, and this discussion are the responsibility of the Program's management.

Overview of the Statement of Changes in Program Assets

The Statement of Changes in Program Assets of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program is intended to show the changes in the Program's assets for fiscal years (FYs) 2003-04 and 2002-03. Accounting for the Program is done outside the State of Wisconsin's central accounting system.

The Statement of Changes in Program Assets presents the Program's receipts and disbursements on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States. Under the cash basis of accounting, receipts are recorded when received and disbursements are recorded when paid. The financial position and activity of the Program is presented on the cash basis of accounting to provide a meaningful presentation to bondholders and extendible municipal commercial paper noteholders regarding resources available to pay debt service. The notes to the financial statement provide additional information that is essential to a full understanding of the data provided in the financial statement.

Noteworthy Financial Activity

The Program originated in January 2000 pursuant to a State of Wisconsin Building Commission Program Resolution adopted on January 19, 2000, and amended and restated on May 2, 2000, and further amended on July 30, 2003. The purpose of the Program is to provide financing for the payment of claims under the State of Wisconsin Petroleum Environmental Cleanup Fund Award (PECFA) program, which is administered by the Wisconsin Department of Commerce. The Building Commission may from time to time adopt Supplemental Resolutions authorizing the issuance of revenue obligations and revenue refunding obligations.

The Program Resolution establishes special trust funds and accounts and fiduciary responsibilities that are to be undertaken by a trustee for the benefit of the bondholders, extendible municipal commercial paper noteholders, and holders of any other obligations that may be issued. The Bank of New York has been appointed as the trustee for the revenue obligations. The trustee is responsible for maintaining the trust funds in accordance with the Program Resolution, which requires investments of trust fund balances to be in accordance with directives established by the Program Resolution.

As shown in Table A, the Program's assets as of June 30, 2004 and June 30, 2003, were $27,642,242 and $19,484,638, respectively, and were invested as follows:

Table A

Program Assets

	June 30, 2004	June 30, 2003	Change
Program Assets Reserved for Debt Service:			
Demand Deposits	$ 19,034,145	$ 19,379,255	-1.8%
Investments	4,104,816	96,926	4,135.0
Total	**23,138,961**	**19,476,181**	18.8
Unreserved Program Assets:			
Demand Deposits	4,503,281	8,457	53,149.2
Total Program Assets, June 30	**$ 27,642,242**	**$ 19,484,638**	41.9

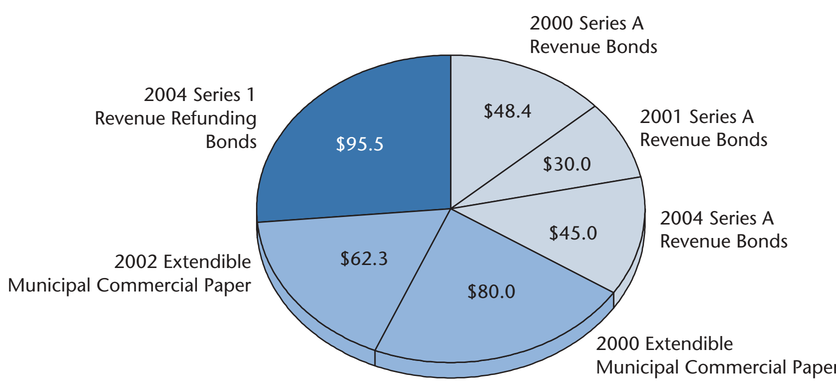
The Program's revenue obligations are issued pursuant to Subchapter II of Chapter 18, Wis. Stats.; s. 101.143(9m), Wis. Stats.; and the Program Resolution and Supplemental Resolutions adopted by the State of Wisconsin Building Commission. The revenue obligations are payable from, and primarily secured by, petroleum inspection fees, as received by the trustee, that suppliers are charged on all petroleum products received for sale in Wisconsin. The revenue obligations are not general obligations of the State of Wisconsin.

During FY 2003-04, $45.0 million of 2004 Series A Bonds were issued to pay for PECFA claims. During FY 2002-03, $62.3 million of 2002 Extendible Municipal Commercial Paper was issued. As of June 30, 2004, a total of $387.6 million of revenue obligations had been issued under the Program Resolution and the Supplemental Resolutions to pay PECFA claims. In addition, during FY 2003-04, the State issued $95.5 million of 2004 Series 1 Revenue Refunding Bonds to advance refunds previously issued revenue obligations. Statutes do not limit the amount of refunding bonds that may be issued, and the principal amount of such bonds does not count toward the principal amount of authorized revenue obligations.

A portion of the revenue bonds issued has already been repaid, and as of June 30, 2004, the total revenue obligations outstanding, excluding those bonds that were defeased as a result of the advance refunding, were $361.2 million, consisting of $123.4 million of revenue bonds, $95.5 million of revenue refunding bonds, and $142.3 million of extendible municipal commercial paper. Figure A displays the breakdown of the obligations outstanding as of June 30, 2004, by type (revenue bond or commercial paper) and series.

Figure A

Petroleum Inspection Fee Revenue Obligations Outstanding as of June 30, 2004
(In Millions)



As noted, $95.5 million of refunding bonds was issued in FY 2003-04 for the advance refunding of previously issued and outstanding 2000 Series A Revenue Bonds. The proceeds from the refunding bonds were deposited with an escrow agent in a separate escrow account. The bond proceeds are invested by the escrow agent in direct general obligations of the United States so that sufficient funds will be available to pay the principal, interest, and redemption price of the refunded bonds as they become due. The refunded bonds are not included in the outstanding revenue bonds, and the related securities in the escrow account are not included in the Program's cash and investments. As a result of the advance refunding, the Program effectively reduced its aggregate debt service payments by $4.8 million over the life of the refunding bonds, as shown in Table B.

Table B

Savings Achieved from Bond Refunding
(In Millions)

	Principal	Interest	Total
2000 Series A Revenue Bonds that Were Defeased	$96.6	$30.2	$126.7
Less:			
2004 Series 1 Revenue Refunding Bonds Issued	95.5	26.5	121.9
Total Savings	**$ 1.1**	**$ 3.7**	**$ 4.8**

The debt service coverage ratio, calculated as the ratio of petroleum inspection fees remitted by the State to the trustee divided by the senior debt service payments made during each fiscal year, was 4.95 in FY 2003-04 and 4.87 in FY 2002-03. The ratios were based on $23,577,360 and $24,072,057 of total senior debt service and $116,635,054 and $117,366,410 of petroleum inspection fees remitted by the State to the trustee, respectively, in each of those years.

Petroleum inspection fees not retained by the trustee for debt service are transferred to the State by the trustee and are used up to the amount authorized by statute to pay PECFA claims, PECFA administrative costs, and other costs and transfers. The net petroleum inspection fees transfers were $92,169,743 in FY 2003-04 and $93,697,749 in FY 2002-03, as shown in Table C.

Table C

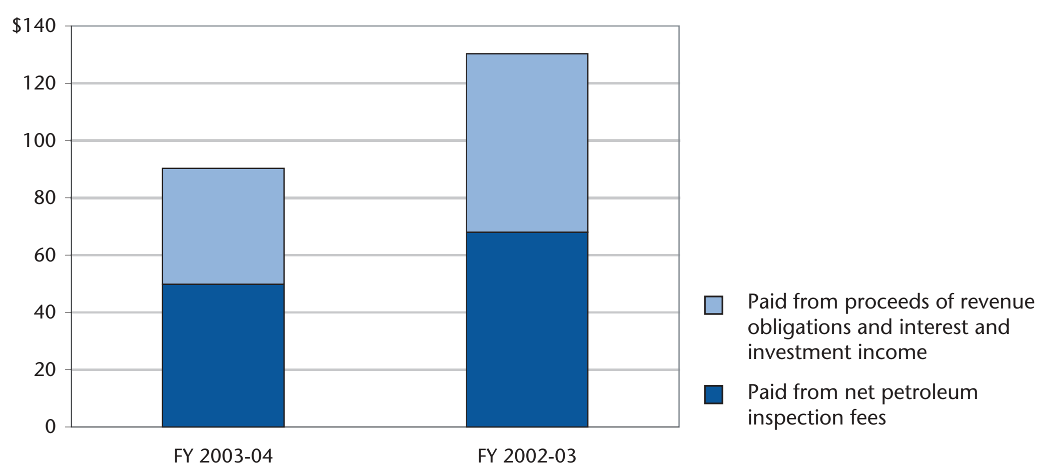
Petroleum Inspection Fees

	FY 2003-04	FY 2002-03	Change
Petroleum Inspection Fees Remitted by the State to the Trustee	$116,634,054	$117,336,410	-0.6%
Petroleum Inspection Fees Fees Retained by the Trustee	24,464,311	23,638,661	3.5
Net Petroleum Inspection Fees Transferred by the Trustee to the State	$ 92,169,743	$ 93,697,749	-1.6

During FY 2003-04, $49.8 million of claims was paid from net petroleum inspection fees. This amount represents a decrease of 26.8 percent from the $68.0 million paid from the fees in FY 2002-03 and is the result of an unanticipated decline in claims volume. In addition, $40.5 million and $62.3 million of claims were paid from the proceeds of revenue obligations, interest, and investments during FY 2003-04 and FY 2002-03, respectively. Figure B shows the funding of PECFA claims paid in FY 2003-04 and FY 2002-03.

Figure B

Petroleum Environmental Cleanup Fund Award Claims Paid
(In Millions)



The Department of Commerce has continued to reduce the amount of approved but unpaid PECFA claims. As of June 30, 3004, approved but unpaid claims were $3.9 million, which is $1.8 million less than at June 30, 2003.

In addition to the $3.9 million in approved claims waiting for payment as of June 30, 2004, approximately $12.1 million of claims submitted to the Department had yet to be both reviewed and approved. The Department estimates there were approximately $66.2 million of additional claims that had not been submitted as of June 30, 2004, for costs that landowners had already incurred as of that date. In addition, the Department estimates that an additional $3.0 million in liabilities may exist related to claimants appealing the Department's determinations on previously finalized claims.

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Statement of Changes in Program Assets ■

Statement of Changes in Program Assets for the Fiscal Years Ended June 30, 2004 and 2003

	Fiscal Year 2003-04		Fiscal Year 2002-03	
Program Assets, July 1		$ 19,484,638		$ 19,959,529
RECEIPTS				
Proceeds from Sale of Bonds (see Note 5)		47,943,973		0
Proceeds from Sale of Extendible Municipal Commercial Paper (see Note 5)		0		62,300,000
Proceeds from Sale of Refunding Bonds (see Notes 5 and 6)		103,233,027		0
Petroleum Inspection Fees Remitted by the State of Wisconsin to the Trustee (see Note 8)	$116,634,054		$ 117,336,410	
Less: Petroleum Inspection Fees Transferred from the Trustee to the State of Wisconsin Petroleum Inspection Fund (see Note 8)	(92,169,743)		(93,697,749)	
Petroleum Inspection Fees Retained by the Trustee		24,464,311		23,638,661
Interest and Investment Income		63,156		90,637
Total Receipts		**175,704,467**		**86,029,298**
TOTAL PROGRAM ASSETS AVAILABLE		**195,189,105**		**105,988,827**
DISBURSEMENTS				
Transfers of Proceeds from Sale of Revenue Obligations and Interest and Investment Income to the State of Wisconsin Petroleum Inspection Fund (see Notes 1 and 10)		40,500,750		62,267,902
Transfer of Proceeds from Refunding Bonds to Escrow (see Note 6)		101,965,442		0
Debt Service (see Note 5):				
Senior debt service—bond principal	12,070,000		11,440,000	
Senior debt service—bond interest	10,139,115		10,839,807	
Senior debt service—commercial paper interest	1,368,245		1,792,250	
Junior subordinate debt service—commercial paper principal	0		0	
Total Debt Service		23,577,360		24,072,057
Debt Issuance Costs		1,388,031		67,171
Other Costs		115,280		97,059
Total Disbursements		**167,546,863**		**86,504,189**
Program Assets Reserved for Debt Service (see Note 4)	23,138,961		19,476,181	
Unreserved Program Assets (see Note 4)	4,503,281		8,457	
PROGRAM ASSETS, JUNE 30		**$ 27,642,242**		**$ 19,484,638**

The accompanying notes are an integral part of this statement.

Notes to the Statement of Changes in Program Assets ▪

1. Description of the Program

The State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program, which is administered jointly by the Wisconsin Department of Commerce and the Wisconsin Department of Administration, originated in January 2000, pursuant to the State of Wisconsin Building Commission Program Resolution for State of Wisconsin Petroleum Inspection Fee Revenue Obligations, adopted on January 19, 2000, and amended and restated on May 2, 2000, and as further amended on July 30, 2003. The Building Commission may from time to time adopt Supplemental Resolutions authorizing the issuance of revenue obligations and revenue refunding obligations. The purpose of the Program is to provide financing for the payment of claims under the State of Wisconsin Petroleum Environmental Cleanup Fund Award (PECFA) program, which is administered by the Wisconsin Department of Commerce.

The Program Resolution establishes special trust funds and accounts and fiduciary responsibilities that are to be undertaken by a trustee for the benefit of the bondholders, extendible municipal commercial paper noteholders, and holders of any other obligations that may be issued. The Bank of New York has been appointed as the trustee for the revenue obligations. The trustee is responsible for maintaining the trust funds in accordance with the Program Resolution, which requires investments of trust fund balances to be in accordance with directives established by the Program Resolution. The Bank of New York is also the registrar for the revenue obligations. In addition, The Bank of New York is the issuing and paying agent for revenue bonds; U.S. Bank Trust National Association is the issuing and paying agent for extendible municipal commercial paper.

Revenue bond and extendible municipal commercial paper proceeds are held by the trustee until the Department of Commerce and the Department of Administration request the trustee to remit specific amounts to the State to pay PECFA claims.

The petroleum inspection fee revenue obligations are payable from, and primarily secured by, petroleum inspection fees that result from a $0.03 per gallon fee charged suppliers for petroleum products received for sale in Wisconsin. These petroleum inspection fees are paid monthly by suppliers to the Wisconsin Department of Revenue, which subsequently forwards the fees to the Program's trustee. All revenues and assets of the Program are restricted for the purposes provided by the Program Resolution under which the revenue obligations are issued. The trustee transfers fees in excess of the amount needed to meet debt service requirements and pay Petroleum Inspection Fee Revenue Obligations Program administrative costs to the State of Wisconsin Petroleum Inspection Fund. The Department of Commerce uses the transferred fees to pay PECFA claims, PECFA program administrative costs, and other costs and transfers.

The Statement of Changes in Program Assets presents only the Petroleum Inspection Fee Revenue Obligations Program and is not intended to present fairly the financial activity of the State of Wisconsin.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Statement of Changes in Program Assets presents the Petroleum Inspection Fee Revenue Obligations Program's receipts and disbursements on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States. Under the cash basis of accounting, receipts are recorded when received and disbursements are recorded when paid. The Program's assets may include cash, consisting of demand deposits held by The Bank of New York and U.S. Bank Trust National Association, and investments. The financial position and activity of the Program is presented on the cash basis of accounting to provide a meaningful presentation to bondholders and extendible municipal commercial paper noteholders regarding resources available to pay debt service.

3. DEPOSITS AND INVESTMENTS

The Program's deposit and investment policies are governed by Wisconsin Statutes and the Program Resolution. The Program is authorized by statutes and the Program Resolution to deposit funds with the trustee and the commercial paper issuing and paying agent. The Program is also authorized by statutes and the Program Resolution to invest funds reserved for debt service in direct obligations of the United States. In addition, the Program is authorized to invest funds not reserved for debt service in direct obligations of the United States; high-quality corporate commercial paper; certificates of deposit; and other investments authorized under s. 25.17(3)(b), Wis. Stats., and permitted by the Program Resolution.

As of June 30, 2004, the demand deposit accounts with the trustee and the commercial paper issuing and paying agent totaled $23,537,426. As of June 30, 2003, the demand deposit accounts with the trustee and the commercial paper issuing and paying agent totaled $19,387,712. Each year, $200,000 was insured against loss by the Federal Deposit Insurance Corporation and, therefore, is categorized as risk category 1 deposits in accordance with Governmental Accounting Standards Board (GASB) Statement No. 3. The remaining $23,337,426 as of June 30, 2004, and $19,187,712 as of June 30, 2003, were not insured or collateralized and, therefore, are categorized as risk category 3.

As of June 30, 2004, the Program held investments, purchased for $4,104,816, consisting of U.S. Treasury Notes with a face value of $4,117,000. These investments, which mature from December 31, 2004 through December 31, 2005, had a fair value of $4,094,695 as of June 30, 2004. These investments were registered and held by the Program's agent in the Program's name and, therefore, were categorized as risk category 1 investments in accordance with GASB Statement No. 3.

As of June 30, 2003, the Program held investments purchased for and with a fair value of $96,926, consisting of shares of Federated U.S. Treasury Cash Reserves, a mutual fund invested in a portfolio of U.S. Treasury securities. These mutual fund investments are not required to be categorized under GASB Statement No. 3. The Program's management determined these investments were not authorized by Wisconsin Statues and the Program Resolution and liquidated the investment in the mutual fund on December 8, 2003.

4. PROGRAM ASSETS

Program assets required to be held in the various interest and principal redemption accounts at the trustee and the issuing and paying agents are reported as Program Assets Reserved for Debt Service. Program assets in excess of those reserved for debt service are reported as Unreserved Program Assets. The Program's unreserved assets are available to pay PECFA claims, debt issuance costs, or administrative costs of the Program.

As of June 30, 2004, the Program's assets totaled $27,642,242. Of this amount, $23,138,961, consisting of $19,034,145 of demand deposits and $4,104,816 of investments, was reserved for debt service. The remaining $4,503,281, consisting of demand deposits, was unreserved.

As of June 30, 2003, the Program's assets totaled $19,484,638. Of this amount, $19,476,181, consisting of $19,379,255 of demand deposits and $96,926 of investments, was reserved for debt service. The remaining $8,457, consisting of demand deposits, was unreserved.

5. REVENUE BONDS AND EXTENDIBLE MUNICIPAL COMMERCIAL PAPER

The Program's revenue obligations are issued pursuant to Subchapter II of Chapter 18, Wis. Stats.; s. 101.143(9m), Wis. Stats.; and the Program Resolution and Supplemental Resolutions adopted by the State of Wisconsin Building Commission. The revenue obligations are payable from, and primarily secured by, petroleum inspection fees that suppliers are charged on all petroleum products received for sale in Wisconsin (see Note 8). The revenue obligations are not general obligations of the State.

Excluding any bonds that were defeased as a result of the issuance of the advance refunded bonds (see Note 6), the senior revenue bonds issued by the Program and outstanding as of June 30, 2004, were as follows:

Senior Revenue Bonds

Date Issued	Series	Interest Rates	Interest Payable	Maturity Through	Amount Issued	June 30, 2004 Amount Outstanding
03/02/2000	2000 Series A	5.25 to 6.0%	Semiannually on 1/1 and 7/1	07/01/2012	$170,250,000	$ 48,420,000
12/18/2001	2001 Series A	5.0	Semiannually on 1/1 and 7/1	07/01/2008	30,000,000	30,000,000
02/04/2004	2004 Series A	3.0 to 5.0	Semiannually on 1/1 and 7/1	07/01/2012	45,000,000	45,000,000
05/20/2004	2004 Series 1	3.0 to 5.0	Semiannually on 1/1 and 7/1	07/01/2012	95,470,000	95,470,000
Total Senior Revenue Bonds					$340,720,000	$218,890,000

The 2000 Series A Petroleum Inspection Fee Revenue Bonds maturing on or after July 1, 2006, are subject to optional redemption on or after July 1, 2005, at prices ranging from 102 to 100 percent of the face value plus accrued interest. The 2001 Series A Petroleum Inspection Fee Revenue Bonds are subject to optional redemption on or after July 1, 2006, which is prior to their maturity, at a price of 100 percent of the face value plus accrued interest. The 2004 Series A Petroleum Inspection Fee Revenue Bonds maturing on or after July 1, 2010, are subject to optional redemption on or after July 1, 2009, at prices ranging from 102 to 100 percent of the face value plus accrued interest. The 2004 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds, maturing on or after July 1, 2010, are subject to optional redemption on or after July 1, 2009, at prices ranging from 102 to 100 percent of the face value plus accrued interest.

During the fiscal years ended June 30, the following changes occurred in revenue bonds outstanding:

Fiscal Year	Balance July 1	Bonds Issued	Principal Repaid or Defeased	Balance June 30
FY 2002-03	$198,500,000	$ 0	$ 11,440,000	$187,060,000
FY 2003-04	187,060,000	140,470,000	108,640,000	218,890,000

As of June 30, 2004, the Program's future debt service requirements for principal and interest for Petroleum Inspection Fee Revenue Bonds 2000 Series A, 2001 Series A, 2004 Series A, and 2004 Series 1 are as follows:

Future Debt Service on Revenue Bonds

Fiscal Year Ending June 30	Principal Amount	Interest Amount	Total Debt Service on Bonds
2005	$ 12,735,000	$ 11,186,845	$ 23,921,845
2006	18,205,000	9,581,888	27,786,888
2007	19,775,000	8,596,081	28,371,081
2008	35,270,000	7,230,000	42,500,000
2009	36,280,000	5,494,500	41,774,500
2010	22,350,000	4,056,025	26,406,025
2011	23,470,000	2,940,600	26,410,600
2012	24,635,000	1,799,625	26,434,625
2013	26,170,000	607,663	26,777,663
Total	$218,890,000	$51,493,227	$270,383,227

The Program may also issue extendible municipal commercial paper, which may have maturities from 1 to 180 days and is not callable prior to maturity. The principal of and interest on the extendible municipal commercial paper will be paid at maturity unless the State exercises its option to extend the maturity date to a date that is up to 270 days after the original issue date. New (rollover) extendible municipal commercial paper may be issued to pay the principal due on maturing extendible municipal commercial paper. Each note bears interest from its date of issuance, at the rate determined on the date of issuance.

Interest payments on extendible municipal commercial paper are on a parity with the payments on the senior bonds. Principal on extendible municipal commercial paper has a junior subordinate pledge and is payable from proceeds of rollover notes, issuance of refunding senior bonds, certain moneys held by the trustee, or other funds made available by the State for this purpose.

The following table presents the extendible municipal commercial paper activity for FY 2002-03 and FY 2003-04.

Fiscal Year	Balance July 1	Commercial Paper Issued	Principal Repaid	Balance June 30
FY 2002-03	$ 80,000,000	$62,300,000	$0	$142,300,000
FY 2003-04	142,300,000	0	0	142,300,000

As of June 30, 2004, the $142,300,000 in outstanding extendible municipal commercial paper had interest rates ranging from 1.06 percent to 1.13 percent, and maturities ranging from August 10, 2004, to September 8, 2004. As of June 30, 2003, the $142,300,000 in outstanding extendible municipal commercial paper had interest rates ranging from 0.90 percent to 1.12 percent, and maturities ranging from July 1, 2003, to August 4, 2003.

Additional series of senior bonds may be issued on parity with the current bond series outstanding and collateralized by an equal lien on the petroleum inspection fees. However, no additional series, other than refunding bonds and bonds issued to fund outstanding extendible municipal commercial paper, may be issued unless, among other things, the debt service coverage ratio, as defined in the Program Resolution, is at least 2.0.

Each month that variable rate debt, such as the extendible municipal commercial paper, is outstanding, the State is required by the Program Resolution to provide to the trustee a certificate setting forth the Program's "variable rate takeout capacity" and "variable rate debt exposure." The "variable rate takeout capacity" measures the State's ability, given certain conservative interest rate assumptions, to convert variable rate debt to fixed-rate debt. "Variable rate debt exposure" measures the Program's outstanding variable rate debt. This certification was required and performed each month during FY 2003-04 and FY 2002-03. Because the Program's ability to convert variable rate debt to fixed-rate debt was higher than the amount of variable rate debt outstanding each month, as evidenced by the Program's variable rate takeout capacity, the State needed to take no further action. For June 2004, the Program's variable rate takeout capacity was calculated to be $383,559,344, which was $241,259,344 higher than the variable rate debt exposure of $142,300,000. For June 2003, the Program's variable rate takeout capacity was calculated to be $411,969,142, which was $269,669,142 higher than the variable rate debt exposure of $142,300,000.

6. ADVANCED REFUNDING

On May 20, 2004, the Program issued $95,470,000 of 2004 Series 1 Revenue Refunding Bonds, the proceeds of which were deposited in an escrow account to provide for the advanced refunding of $96,570,000 of the Program's 2000 Series A Revenue Bonds. The refunding bond proceeds in the amount of $101,965,442 have been invested by the escrow agent in U.S. Treasury obligations and certain other government securities so that sufficient monies will be available to pay the principal, interest, and redemption price of the refunded bonds. As a result, $96,570,000 of the Program's 2000 Series A Revenue Bonds are considered to be defeased, and the refunded bonds are not included in the revenue bonds outstanding as of June 30, 2004, as summarized in Note 5, and the related securities in the escrow account are not included in the Program Assets as of June 30, 2004. As a result of the advanced refunding, the Program effectively reduced its aggregate debt service payments by $4.8 million over the life of the refunding bonds and obtained an economic gain of $4.0 million.

The revenue bonds defeased by the 2004 Series 1 refunding revenue bonds are as follows:

Series	Maturity	Principal Amount	Redemption Date	Redemption Price
2000 Series A	July 1, 2007	$15,115,000	July 1, 2005	102%
2000 Series A	July 1, 2008	15,980,000	July 1, 2005	102%
2000 Series A	July 1, 2009	16,885,000	July 1, 2005	102%
2000 Series A	July 1, 2010	17,800,000	July 1, 2005	102%
2000 Series A	July 1, 2011	18,790,000	July 1, 2005	102%
2000 Series A	July 1, 2012	12,000,000	July 1, 2005	102%
Total Refunded Bonds		$96,570,000		

7. DEBT AUTHORITY FOR THE PROGRAM

In addition to the $483,020,000 in petroleum inspection fee revenue obligations issued through June 30, 2004, Wisconsin Statutes and the State of Wisconsin Building Commission have authorized the Program to issue additional revenue obligations of up to $49,076,000, plus an additional amount to pay issuance and administrative costs, make any necessary deposits to reserve funds, or pay accrued or capitalized interest. Further, the Building Commission has authorized the Program to issue revenue bonds to fund any or all of the outstanding extendible municipal commercial paper and to issue up to $19,530,000 in revenue refunding bonds to refund currently outstanding bonds, plus an additional amount to pay issuance and administrative costs, make any necessary deposits to reserve funds, or pay accrued or capitalized interest.

8. PETROLEUM INSPECTION FEES

Petroleum inspection fees result from the fees imposed under s. 168.12(1) Wis. Stats., and payments received under ss. 101.143(4)(h)1m, 101.143(5)(a), and 101.143(5)(c), Wis. Stats. Under s. 168.12(1), Wis. Stats., a $0.03 per gallon fee is imposed by the State on suppliers for all petroleum products received for sale in Wisconsin. The fees are paid to the State of Wisconsin Department of Revenue by suppliers along with motor fuel taxes. The Department of Revenue determines the amount collected for the fees and remits it to the Program's trustee on a monthly basis. For certain months during FY 2003-04, the Department of Revenue transferred $8.8 million to the trustee and made adjustments in subsequent months when actual collections became known. The other petroleum inspection fees consist of penalty payments made under s. 101.143(4)(h)1m, Wis. Stats., by consultants for submitting claims for ineligible costs; proceeds under s. 101.143(5)(a), Wis. Stats., from the sale of remedial equipment and supplies that had originally been paid for by PECFA awards; and net recoveries under s. 101.143(5)(c), Wis. Stats., related to the Wisconsin Attorney General's actions against fraudulent claims.

The trustee transfers the petroleum inspection fees in excess of the amount needed to meet debt service requirements and to pay Petroleum Inspection Fee Revenue Obligations Program administrative costs to the State of Wisconsin Petroleum Inspection Fund, free of the first lien pledge of the Program Resolution. The Department of Commerce uses the net fees to pay PECFA claims, PECFA program administrative costs, and other costs and transfers.

From July 1, 2002, through June 30, 2004, the following amounts of petroleum inspection fees were remitted by the Wisconsin Department of Revenue to the trustee, retained by the trustee to meet debt service requirements and pay Petroleum Inspection Fee Revenue Obligations Program administrative costs, and transferred by the trustee to the State of Wisconsin Petroleum Inspection Fund.

Month	Petroleum Inspection Fees Remitted by the State to the Trustee	Petroleum Inspection Fees Fees Retained by the Trustee	Petroleum Inspection Fees Transferred by the Trustee to the State
July 2003	$ 9,826,106	$ 2,017,062	$ 7,809,044
August	10,204,569	1,993,516	8,211,053
September	9,888,788	1,965,570	7,923,218
October	12,816,429	1,995,589	10,820,840
November	8,856,448	2,032,956	6,823,492
December	8,800,000	2,025,950	6,774,050
January 2004	8,800,000	2,031,516	6,768,484
February	8,800,000	2,060,678	6,739,322
March	11,315,333	1,983,516	9,331,817
April	8,800,000	2,006,219	6,793,781
May	9,726,381	1,981,225	7,745,156
June	8,800,000	2,370,514	6,429,486
Total FY 2003-04	$116,634,054	$24,464,311	$92,169,743
July 2002	$ 10,206,822	$ 1,899,073	$ 8,307,749
August	8,273,380	1,978,073	6,295,307
September	13,834,541	2,006,073	11,828,468
October	10,148,782	2,026,073	8,122,709
November	6,659,739	2,006,073	4,653,666
December	12,357,338	1,608,935	10,748,403
January 2003	5,503,883	2,095,372	3,408,511
February	12,261,961	2,002,420	10,259,541
March	10,693,166	2,004,420	8,688,746
April	7,449,198	2,027,920	5,421,278
May	8,759,379	2,004,420	6,754,959
June	11,188,221	1,979,809	9,208,412
Total FY 2002-03	$117,336,410	$23,638,661	$93,697,749

9. DEBT SERVICE COVERAGE RATIO FOR SENIOR DEBT

There are alternative methods to calculate debt service coverage. For purposes of additional analysis, the debt service coverage ratios for senior debt for FY 2003-04 and FY 2002-03 follow. They are calculated as the ratio of petroleum inspection fees remitted to the trustee during the respective fiscal years, divided by the senior debt service payments made during each fiscal year.

Debt Service Coverage Ratio for Senior Debt

	Fiscal Year 2003-04		Fiscal Year 2002-03	
Fees Remitted to the Trustee		$116,634,054		$117,336,410
Senior Debt Service:				
Principal—Bonds	$12,070,000		$11,440,000	
Interest—Bonds	10,139,115		10,839,807	
Interest—Commercial Paper	1,368,245		1,792,250	
Total Senior Debt Service		$ 23,577,360		$ 24,072,057
Debt Service Coverage Ratio for Senior Debt		4.95		4.87

10. PECFA CLAIMS

The Petroleum Inspection Fee Revenue Obligations Program was established during FY 1999-2000, and bonds and extendible municipal commercial paper were issued to reduce a backlog that had accumulated because at that time approved PECFA claims significantly exceeded the petroleum inspection fee revenues available to pay the claims. While the backlog has been largely eliminated, PECFA claims continue to be submitted to the Department of Commerce and, through FY 2003-04, additional bonds and extendible municipal commercial paper continued to be issued to pay approved PECFA claims.

The following table summarizes the activity related to PECFA claims during FY 2003-04 and FY 2002-03.

Summary of PECFA Claims
July 1, 2002 through June 30, 2004
(In Millions)

	FY 2003-04	FY 2002-03
Approved but Unpaid PECFA Claims as of July 1	$ 5.7	$ 30.7
Claims Approved for Payment during the Fiscal Year	88.5	105.3
Total Approved PECFA Claims	94.2	136.0
Less Claims Paid:		
Paid from Proceeds of Revenue Obligations and Interest and Investment Income	40.5	62.3
Paid From Net Petroleum Inspection Fees	49.8	68.0
Total Claims Paid during the Fiscal Year	90.3	130.3
Approved but Unpaid PECFA Claims as of June 30	$ 3.9	$ 5.7

In addition to the $3.9 million in approved claims waiting for payment as of June 30, 2004, approximately $12.1 million of claims submitted to the Department of Commerce had yet to be both reviewed and approved. The Department estimates that there were approximately $66.2 million of additional claims that had not been submitted as of June 30, 2004, for costs that landowners had already incurred as of that date. In addition, the Department estimates that an additional $3.0 million in liabilities may exist related to claimants appealing the Department's determinations on previously finalized claims.

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Report on Control and Compliance ■

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on Audits of a Financial Statement Performed in Accordance with Government Auditing Standards

We have audited the cash-basis Statement of Changes in Program Assets of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program for the years ended June 30, 2004, and June 30, 2003, and have issued our report thereon dated December 6, 2004. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the Program's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Statement of Changes in Program Assets and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Program's Statement of Changes in Program Assets is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits and, accordingly, we do not express such an opinion. The results of our tests disclosed one area of noncompliance that is required to be reported under *Government Auditing Standards*.

As discussed in Note 3, based on the advice of legal counsel, program management determined that certain investments in a mutual fund invested in a portfolio of U.S. Treasury securities did not comply with requirements of Wisconsin Statutes and the Program Resolution because these investments did not constitute direct obligations of the U.S. Treasury. On December 8, 2003, program management liquidated these mutual fund investments and deposited the proceeds in an authorized demand deposit account. We also noted certain immaterial instances of noncompliance that we have reported to the management of the program in a separate letter dated December 6, 2004.

This independent auditor's report is intended for the information and use of the program's management and the Wisconsin Legislature. This independent auditor's report, upon submission to the Joint Legislative Audit Committee, is a matter of public record and its distribution is not limited. However, because we do not express an opinion on internal control over financial reporting or on compliance, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

December 6, 2004

by Bryan Naab

Bryan Naab
Audit Director