

AN AUDIT

*Petroleum Inspection Fee
Revenue Obligations Program*

01-19

November 2001

2001-2002 Joint Legislative Audit Committee Members

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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November 29, 2001

Senator Gary R. George and
Representative Joseph K. Leibham, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator George and Representative Leibham:

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 period July 1, 2000 through June 30, 2001. We were able to express our unqualified opinion on the Program's Statement of Changes in Program Assets and related notes.

The Petroleum Inspection Fee Revenue Obligations Program provides financing for payment of claims under the Wisconsin Petroleum Environmental Cleanup Fund Award (PECFA) program. As of December 31, 1999, there was a backlog of \$196 million in approved but unpaid PECFA claims. To reduce this backlog, the Legislature, through 1999 Wisconsin Act 9, authorized the State to issue \$270 million of revenue obligations to be repaid by a \$0.03 per gallon fee charged suppliers for petroleum products sold in Wisconsin. These revenue obligations, which may include bonds, commercial paper, or other obligations, are not general obligations of the State.

Between March 2, 2000, when the Petroleum Inspection Fee Revenue Obligations Program started, and June 30, 2001, the State issued \$250.25 million of revenue obligations. Proceeds from the sale of this debt, along with petroleum inspection fees collected from suppliers in excess of debt service requirements, allowed the State to reduce the backlog and, as of June 30, 2001, there was a backlog of less than \$15 million in approved but unpaid PECFA claims.

However, the Department of Commerce continues to receive PECFA reimbursement claims and, as of June 30, 2001, it had not yet reviewed and approved over \$20 million in claims. In addition, the Department estimates that land owners have yet to submit claims for at least \$200 million for costs that they have already incurred. In order to provide funds to pay additional claims, the Legislature, through 2001 Wisconsin Act 16, authorized the issuance of \$72 million of additional revenue obligations. Based on this increased bonding authority, the State plans to issue \$30 million of additional Petroleum Inspection Revenue Bonds in December 2001.

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

Respectfully submitted,

A handwritten signature in cursive script that reads 'Janice Mueller'.

Janice Mueller
State Auditor

JM/BN/ss

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 year ended June 30, 2001. 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States 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 audit 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 audit provides 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 is not intended to present fairly the financial position and activity of the State of Wisconsin.


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.

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, 2001, and the receipts and disbursements of the program for the period from July 1, 2000 through June 30, 2001, on the cash basis of accounting.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 26, 2001, 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, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

LEGISLATIVE AUDIT BUREAU

November 26, 2001

by 
Bryan Naab
Audit Director

State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program
Statement of Changes in Program Assets
for the Fiscal Year Ended June 30, 2001

Program Assets, July 1, 2000 \$ 29,826,342

Receipts

Proceeds from Sale of Bonds	\$	0	
Proceeds from Sale of Extendible Municipal Commercial Paper		20,000,000	
Petroleum Inspection Fees Remitted by the State of Wisconsin to the Trustee	\$	114,303,667	
Less: Petroleum Inspection Fees Transferred from the Trustee to the State of Wisconsin Petroleum Inspection Fund		<u>(100,658,894)</u>	
Petroleum Inspection Fees Retained by the Trustee		13,644,773	
Interest and Investment Income		<u>538,584</u>	
Total Receipts			<u>34,183,357</u>
Total Program Assets Available			<u>64,009,699</u>

Disbursements

Transfers to the State of Wisconsin for Payment of Petroleum Environmental Cleanup Fund Award Claims		43,694,566	
Debt Service (see Note 4):			
Senior Debt Service—Principal	1,750,000		
Senior Debt Service—Interest	10,930,084		
Junior Subordinate Debt Service—Principal	<u>0</u>		
Total Debt Service		12,680,084	
Debt Issuance Costs		12,414	
Other Costs		<u>62,912</u>	
Total Disbursements			<u>56,449,976</u>
Program Assets Reserved for Debt Service		7,557,736	
Unreserved Program Assets		<u>1,987</u>	
Program Assets, June 30, 2001			<u><u>\$ 7,559,723</u></u>

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 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 (the Program Resolution). 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 State of Wisconsin Department of Commerce.

The Program Resolution establishes special trust funds and accounts and fiduciary responsibilities that are to be undertaken by a corporate 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 and paying agent for revenue bonds. The U.S. Bank Trust National Association is the issuing and paying agent and registrar for extendible municipal commercial paper.

Pursuant to the Program Resolution, the State of Wisconsin issued \$170,250,000 of 2000 Series A Petroleum Inspection Fee Revenue Bonds and \$60,000,000 of Petroleum Inspection Fee Revenue Extendible Municipal Commercial Paper during fiscal year (FY) 1999-2000, and an additional \$20,000,000 of Petroleum Inspection Fee Revenue Extendible Municipal Commercial Paper during FY 2000-01. Revenue bond and extendible municipal commercial paper proceeds are held by the trustee until the Department of Commerce requests 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. The petroleum inspection fees are paid monthly by suppliers to the State of Wisconsin Department of Revenue, which subsequently forwards the fees to the revenue obligations 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 bond redemption and debt service requirements to the State of Wisconsin Petroleum Inspection Fund. The Department of Commerce uses the transferred fees to pay PECFA claims, administrative costs, and other costs.

The financial statement presents only the Petroleum Inspection Fee Revenue Obligations Program and is not intended to present fairly the financial position and activity of the State of Wisconsin.

2. Summary of Significant Accounting Policies

Basis of Presentation - The accompanying Statement of Changes in Program Assets of the Petroleum Inspection Fee Revenue Obligations Program presents the program's receipts and disbursements on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. 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 the 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.

Unreserved Program Assets - 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. Periodically, the State requests the trustee to remit the program's unreserved assets to the State to pay for these costs.

3. Deposits and Investments

The program's deposit and investment policies are governed by the Program Resolution and Wisconsin Statutes. The program is authorized by statute to invest in direct obligations of the United States maturing within one year from the date of investment. In addition, statutes allow those funds not reserved for debt service to be invested in direct obligations of the United States, its agencies and corporations, and certain banks; high-quality corporate commercial paper; and certificates of deposit.

Beginning with the initial sale of the Petroleum Inspection Fee Revenue Bonds on March 2, 2000, through the end of the fiscal year ended June 30, 2001, the trustee maintained the Petroleum Inspection Fee Revenue Obligations Program's funds either in demand deposit accounts with the Bank of New York and the U.S. Bank Trust National Association or in investments consisting of U.S. Treasury Bills.

As of June 30, 2001, the program's assets totaled \$7,559,723 in cash, which was held in demand deposit accounts. Of this balance, \$200,000 was covered by FDIC insurance and is categorized as risk category 1 deposits in accordance with Governmental Accounting Standards Board (GASB) Statement No. 3. The remaining \$7,359,723 is not insured or collateralized and, therefore, is categorized as risk category 3.

Of the Program Assets of \$7,559,723 as of June 30, 2001, \$7,557,736 was reserved for debt service. The remaining \$1,987 was reported as Unreserved Program Assets.

4. Revenue Bonds and Extendible Municipal Commercial Paper

The Program's revenue obligations are issued pursuant to Subchapter II of Chapter 18 of Wisconsin Statutes; 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, as received by the trustee (see note 5). The revenue obligations are not general obligations of the State.

On March 2, 2000, the State issued \$170,250,000 of State of Wisconsin Petroleum Inspection Fee Revenue Bonds, 2000 Series A, which are senior bonds that bore interest at rates from 5.00 percent to 6.00 percent, payable semiannually on July 1 and January 1. During FY 2000-01, \$1,750,000 of the bonds matured. The remaining \$168,500,000 of bonds mature in annual scheduled installments from July 1, 2002 to July 1, 2012. Prior to their maturity, the bonds 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.

As of June 30, 2001, the future debt service for the Petroleum Inspection Fee Revenue Bonds, 2000 Series A, was \$236,232,553, consisting of \$168,500,000 in principal and \$67,732,553 in interest. The bond redemption and debt service requirements for the Petroleum Inspection Fee Revenue Bonds, 2000 Series A, in the years subsequent to June 30, 2001, are as follows:

<u>Fiscal Year</u> <u>Ending June 30</u>	<u>Principal Amount</u>	<u>Interest</u> <u>Amount</u>	<u>Total</u> <u>Debt Service</u>
2002	\$ 0	\$ 9,600,240	\$ 9,600,240
2003	11,440,000	9,285,640	20,725,640
2004	12,070,000	8,639,115	20,709,115
2005	12,735,000	7,925,140	20,660,140
2006	13,495,000	7,138,240	20,633,240
2007	14,305,000	6,329,884	20,634,884
2008	15,115,000	5,491,821	20,606,821
2009	15,980,000	4,604,840	20,584,840
2010	16,885,000	3,696,520	20,581,520
2011	17,800,000	2,743,875	20,543,875
2012	18,790,000	1,700,400	20,490,400
2013	<u>19,885,000</u>	<u>576,838</u>	<u>20,461,838</u>
Totals	\$168,500,000	\$67,732,553	\$236,232,553

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 (“roll-over”) 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.

As of June 30, 2001, \$80,000,000 in outstanding extendible municipal commercial paper had interest rates ranging from 2.9 percent to 3.2 percent, and maturities ranging from July 2, 2001 to September 6, 2001.

Additional series of senior bonds may be issued on a 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, 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 State’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 State’s outstanding variable rate debt. This certification was required and performed each month during FY 2000-01. Because the State’s ability to convert variable rate debt to fixed rate debt was higher than the amount of variable rate debt outstanding each month, the State needed to take no further action.

5. Petroleum Inspection Fees

Petroleum inspection fees result from a \$0.03 per gallon fee imposed by the State under s. 168.12(1), Wis. Stats., 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 trustee on a monthly basis. The trustee transfers the fees in excess of the amount needed

to service the bond redemption and debt service requirements 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.

From July 1, 2000 through June 30, 2001, the following amounts of petroleum inspection fees were remitted by the State of Wisconsin Department of Revenue to the trustee, retained by the trustee to meet debt service requirements of the Program, and transferred by the trustee to the State of Wisconsin Petroleum Inspection Fund.

<u>Month</u>	<u>Fees Remitted by the State to the Trustee</u>	<u>Fees Retained by the Trustee</u>	<u>Fees Transferred by the Trustee to the State</u>
July 2000	\$ 11,017,557	\$ 1,058,020	\$ 9,959,537
August	9,805,668	1,041,020	8,764,648
September	9,581,492	1,041,020	8,540,472
October	10,422,248	994,520	9,427,728
November	8,887,756	992,020	7,895,736
December	9,563,479	1,092,020	8,471,459
January 2001	8,965,158	1,092,020	7,873,138
February	10,047,622	1,117,020	8,930,602
March	9,662,194	1,092,020	8,570,174
April	8,185,362	1,092,020	7,093,342
May	9,311,493	1,103,520	8,207,973
June	<u>8,853,638</u>	<u>1,929,553</u>	<u>6,924,085</u>
Total	\$114,303,667	\$13,644,773	\$100,658,894

The above table presents the inspection fees on a cash basis. For purposes of additional analysis, the table below presents the petroleum inspection fees on the modified accrual basis of accounting as reported in the State's comprehensive annual financial reports for the five most recent prior fiscal years. These modified accrual amounts represent the fees earned during each fiscal year, a portion of which may not have been collected in cash until up to 60 days after the end of the fiscal year.

<u>Fiscal Year</u>	<u>Fees Earned</u>
1999-2000	\$111,564,000
1998-99	110,742,000
1997-98	103,842,000
1996-97	105,761,000
1995-96	104,882,000

6. 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 ratio for senior debt for FY 2000-01 provided below is the ratio of petroleum inspection fees remitted to the trustee during FY 2000-01, divided by the senior debt service payments made during the fiscal year.

Debt Service Coverage Ratio for Senior Debt
Fiscal Year 2000-01

Fees Remitted to the Trustee		\$114,303,667
Senior Debt Service:		
Principal—Bonds	\$ 1,750,000	
Interest—Bonds	8,002,456	
Interest—Commercial Paper	<u>2,927,628</u>	
Total Senior Debt Service		\$ 12,680,084
Debt Service Coverage Ratio for Senior Debt		9.01

7. Contingencies and Commitments

In addition to the \$250,250,000 of petroleum inspection fee revenue obligations issued through June 30, 2001, Wisconsin Statutes authorized the program to issue additional revenue obligations of \$20,160,000 plus an additional amount to pay issuance and administrative costs, make any necessary deposits to a reserve fund, or pay accrued or capitalized interest. Further, the Building Commission has authorized the program to issue revenue bonds to refund any or all of the outstanding extendible municipal commercial paper.

The Petroleum Inspection Fee Revenue Obligations Program was established and the program's bonds and extendible municipal commercial paper were issued to reduce a backlog that had accumulated because approved PECFA claims significantly exceeded the petroleum inspection fee revenues available to pay the claims. The bonds and commercial paper sold during FY 1999-2000, along with petroleum inspection fees collected during that year, provided funding to reduce the backlog of approved but unpaid PECFA claims from \$195.5 million to \$15.8 million as of June 30, 2000.

The following table summarizes the activity related to PECFA claims during FY 2000-01.

Summary of PECFA Claims
July 1, 2000 through June 30, 2001
(in millions)

Approved but Unpaid PECFA Claims as of June 30, 2000		\$ 15.8
Claims Approved for Payment July 1, 2000–June 30, 2001		123.2
Less Claims Paid:		
Paid from proceeds of revenue obligations and interest and investment income	\$43.7	
Paid from net petroleum inspection fees	<u>80.7</u>	<u>124.4</u>
Approved but Unpaid PECFA Claims as of June 30, 2001		\$ 14.6

In addition to the \$14.6 million in approved claims waiting for payment as of June 30, 2001, approximately \$20.3 million of claims submitted to the Department of Commerce had yet to be reviewed and approved. There is also a substantial number of claims that were not submitted to the Department as of June 30, 2001, for costs that landowners had already incurred as of that date. The Department estimates that the unsubmitted claims total at least \$200 million. In addition, the Department estimates that an additional \$4 million in liabilities may exist related to claimants appealing the Department’s determinations on previously finalized claims.

The Department expects new PECFA claims received to continue to exceed the amount of petroleum inspection fees available to pay them. As a result, the State may issue additional revenue obligations to reduce or prevent increases in the backlog.

8. Subsequent Events

In 2001 Wisconsin Act 16, which was enacted on August 30, 2001, the Legislature increased the amount of revenue obligations that may be issued from \$270 million to \$342 million plus an additional amount to pay issuance and administrative costs, make any necessary deposits to a reserve fund, or pay accrued or capitalized interest. As a result of this increased issuance authority, plus the \$20,160,000 available authority as of June 30, 2001, the State was authorized to issue up to \$92,160,000 in additional petroleum inspection fee revenue obligations to pay PECFA claims.

On September 19, 2001, the Building Commission authorized the issuance of up to \$94,250,000 of additional Petroleum Inspection Revenue Bonds to pay approved PECFA claims of \$92,160,000 and to provide \$2,090,000 to pay issuance and administrative costs, make any necessary deposits to a reserve fund, or to pay accrued or capitalized interest.

Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting Based on an Audit 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 Petroleum Inspection Fee Revenue Obligations Program for the year ended June 30, 2001, and have issued our report thereon dated November 26, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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 audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, 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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a 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 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.

This independent auditor's report is intended for the information and use of the program's management and the Wisconsin Legislature's Joint Legislative Audit Committee. 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 compliance or provide assurance on internal control over financial reporting, this report is not intended to be used by anyone other than these specified parties.

LEGISLATIVE AUDIT BUREAU

November 26, 2001

by 
Bryan Naab
Audit Director