AN AUDIT

Petroleum Inspection Fee Revenue Obligations Program

00-16

December 2000

LEGISLATIVE AUDIT BUREAU

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TABLE OF CONTENTS

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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December 15, 2000

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

Dear Senator George and Representative Kelso:

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 March 2, 2000 through June 30, 2000. 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. In a previous evaluation of the PECFA program (report 98-14), we noted a large backlog of approved but unpaid PECFA claims and identified options for the Legislature's consideration. To address the backlog, the Legislature authorized the State to issue up to $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, 2000, the State issued $230 million of revenue obligations. An additional $20 million was issued in December 2000. Proceeds from the sale of this debt, along with petroleum inspection fees collected from suppliers in excess of debt service requirements, have allowed the State to reduce the December 31, 1999 backlog from almost $196 million in approved but unpaid PECFA claims to less than $16 million as of June 30, 2000. However, as of June 30, 2000, the Department of Commerce had yet to review for approval approximately $25 million in claimed costs, and it continues to receive new claims every month.

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
State Auditor

JM/BN/cm

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 from March 2, 2000 through June 30, 2000. 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 generally accepted auditing standards 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.

The Petroleum Inspection Fee Revenue Obligations Program began on March 2, 2000. As a result, the Statement of Changes in Program Assets for this period presents activity for less than a full year.

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 generally accepted accounting principles.

In our opinion, the Statement of Changes in Program Assets referred to above presents fairly, in all material respects, the Program’s assets as of June 30, 2000, and the receipts and disbursements of the Petroleum Inspection Fee Revenue Obligations Program for the period from March 2, 2000 through June 30, 2000, on the cash basis of accounting.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 11, 2000 on our consideration of the Program's internal control over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts, and grants.

LEGISLATIVE AUDIT BUREAU

December 11, 2000 by

Bryan Naab
Audit Director

State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program
Statement of Changes in Program Assets
for the Partial Year Ended June 30, 2000

			March 2, 2000 through June 30, 2000
Program Assets, March 2, 2000			$ 0
Receipts			
Proceeds from Sale of Bonds		$ 173,041,306	
Proceeds from Sale of Extendible Municipal Commercial Paper		60,000,000	
Petroleum Inspection Fees Remitted by the State of Wisconsin to the Trustee	$ 32,502,522		
Less: Petroleum Inspection Fees Transferred from the Trustee to the State of Wisconsin Petroleum Inspection Fund	(27,847,429)		
Petroleum Inspection Fees Retained by the Trustee		4,655,093	
Interest and Investment Income		1,003,789	
Total Receipts			238,700,188
Total Program Assets Available			238,700,188
Disbursements			
Transfers to the State of Wisconsin for Payment of Petroleum Environmental Cleanup Fund Award Claims		207,434,297	
Debt Service--Principal		0	
Debt Service--Interest		0	
Debt Issuance Costs		1,386,712	
Other Costs		52,837	
Total Disbursements			208,873,846
Program Assets Reserved for Debt Service		6,467,185	
Unreserved Program Assets		23,359,157	
Program Assets, June 30, 2000			$ 29,826,342

The accompanying notes are an integral part of this statement.

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 on March 2, 2000, and $60,000,000 of Petroleum Inspection Fee Revenue Extendible Municipal Commercial Paper beginning on May 9, 2000. 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 secured by, petroleum inspection fees that result from a $0.03 per gallon fee charged suppliers for petroleum products received for sale in the State of 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 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 required to be 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.

From March 2, 2000 through June 30, 2000, the trustee maintained the Petroleum Inspection Fee Revenue Obligations Program's funds in demand deposit accounts with the Bank of New York and the U.S. Bank Trust National Association and in investments consisting of U.S. treasury bills. As of June 30, 2000, the demand deposit accounts totaled $29,026,858, of which $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 $28,826,858 is not insured or collateralized and, therefore, is categorized as risk category 3.

As of June 30, 2000, the Program held investments, purchased for $799,484, consisting of U.S. treasury bills with a face value of $824,000 and maturing on December 21, 2000. The investments were registered and held by the Program's agent in the Program's name. Therefore, the Program's investments are categorized as risk category 1 investments in accordance with GASB Statement No. 3.

As of June 30, 2000, the Program's assets totaled $29,826,342. Of this amount, $6,467,185, consisting of $5,667,701 of cash and $799,484 of investments, was reserved for debt service. The remaining $23,359,157 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 the 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 solely from, and secured by, petroleum inspection fees that suppliers are charged on all petroleum products received for sale in the State of Wisconsin, as received by the trustee (see note 5). The revenue obligations are not general obligations of the State.

The $170,250,000 of State of Wisconsin Petroleum Inspection Fee Revenue Bonds, 2000 Series A, are senior bonds that bear interest at rates from 5.00 percent to 6.00 percent, payable semiannually commencing July 1, 2000. The bonds mature in scheduled installments on July 1, 2000, and annually from July 1, 2002 to July 1, 2012. The bonds are subject to optional redemption, prior to their maturity, on or after July 1, 2005, at prices ranging from 102 to 100 percent of the face value plus accrued 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, 2000, are as follows:

Fiscal Year Ending June 30	Principal Amount	Interest Amount	Total Debt Service
2001	$ 1,750,000	$ 8,002,456	$ 9,752,456
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	19,885,000	576,838	20,461,838
Totals	$170,250,000	$75,735,009	$245,985,009

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.

The $60,000,000 of extendible municipal commercial paper has 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. As of June 30, 2000, the outstanding extendible municipal commercial paper had interest rates ranging from 4.625 percent to 4.9 percent and maturities ranging from July 19, 2000 to August 25, 2000.

Interest payments on extendible municipal commercial paper are on a parity with the payments on the senior bonds. Principal on extendible municipal commercial paper is subordinate to these pledges 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.

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. During fiscal year (FY) 1999-2000, this certification was required and performed for the months of May and June. Because the State's ability to convert variable rate debt to fixed rate debt was higher than the amount of variable rate debt outstanding for both months, 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 the State of 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.

Through June 2000, 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.

Month, 2000	Fees Remitted by the State to the Trustee	Fees Retained by the Trustee	Fees Transferred by the Trustee to the State
March	$ 8,800,000	$1,068,358	$ 7,731,642
April	8,800,000	1,718,358	7,081,642
May	6,102,522	1,068,358	5,034,164
June	8,800,000	800,020	7,999,980
Total	$32,502,522	$4,655,094	$27,847,428

For purposes of additional analysis, the petroleum inspection fees collected by the State for the past five fiscal years are provided below.

Fiscal Year	Fees Earned
1999-2000	$111,564,000
1998-99	110,742,000
1997-98	103,842,000
1996-97	105,761,000
1995-96	104,822,000

6. Debt Service Coverage

There are alternative methods to calculate debt service coverage. For purposes of additional analysis, the debt service coverage ratio provided below is the ratio of petroleum inspection fees remitted to the trustee during FY 1999-2000, divided by the debt service payments made during the fiscal year.

		Debt Service					
FY[(A)]	Fees Remitted to the Trustee[(B)]	Bond Principal	Bond Interest	Commercial Paper Principal	Commercial Paper Interest	Total Debt Service	Debt Service Coverage[(C)]
99-00	$32,502,522	$0	$0	$0	$0	$0	N/A

(A) The program began on March 2, 2000.

(B) This includes petroleum inspection fees remitted by the State of Wisconsin to the Program Trustee for the four-month period March 2000 through June 2000. In contrast, the fees collected by the State of Wisconsin for the 12-month period ended June 30, 2000, totaled $111,563,668.

(C) The debt service coverage ratio is not applicable for FY 1999-2000 since there was no debt service paid prior to July 1, 2000. However, the ratio of remitted fees to debt service payments to be made on July 1, 2000, is 6.56: the $32,502,522 in fees remitted to the trustee, divided by $4,952,336 of debt service payments.

7. Contingencies and Commitments

In addition to the $230,250,000 of petroleum inspection fee revenue obligations issued through June 30, 2000, Wisconsin Statutes and the State of Wisconsin Building Commission have authorized the Program to issue an additional $40,160,000, plus issuance and administrative costs and accrued interest, of extendible municipal commercial paper. 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 in recent years because approved PECFA claims significantly exceeded the petroleum inspection fee revenues available to pay the claims. As of December 31, 1999, the backlog of approved but unpaid PECFA claims had reached $195.5 million. As summarized below, the bonds and extendible municipal commercial paper issued during FY 1999-2000 provided funding to reduce the backlog.

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

Approved but unpaid PECFA claims as of December 31, 1999		$195.5
Claims approved for payment January 1–June 30, 2000		70.0
Less claims paid:		
Paid from proceeds of revenue obligations	$207.4	
Paid from net petroleum inspection fees	42.3	249.7
Approved but unpaid PECFA claims as of June 30, 2000		$ 15.8

As of June 30, 2000, there existed $15.8 million in approved claims waiting for payment. In addition, as of June 30, 2000, the Department of Commerce had yet to review for approval approximately $25 million in claimed costs. The Department expects that new PECFA claims will continue for at least the next few years to exceed the amount of fees available to pay them. As a result, the State may issue additional revenue obligations to reduce or prevent increases in the backlog in the future.

8. Subsequent Events

On December 4, 2000, the Program issued an additional $20,000,000 of extendible municipal commercial paper to pay approved PECFA claims.

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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 Statement of Changes in Program Assets of the Petroleum Inspection Fee Revenue Obligations Program for the period from March 2, 2000 through June 30, 2000 and have issued our report thereon dated December 11, 2000. We conducted our audit in accordance with generally accepted auditing standards 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 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 statements 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 report is intended for the information of the Program's management and the Wisconsin Legislature's Joint Legislative Audit Committee. This restriction is not intended to limit the distribution of this report, which, 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

December 11, 2000 by

Bryan Naab
Audit Director