

Report 16-8
November 2016

Petroleum Inspection Fee Revenue Obligations Program

Fiscal Year 2015-16

STATE OF WISCONSIN



Legislative Audit Bureau ■

Petroleum Inspection Fee Revenue Obligations Program

Fiscal Year 2015-16

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Joe Chrisman
State Auditor

November 9, 2016

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

At the request of the Department of Natural Resources and the Department of Administration, and to help fulfill 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 ended June 30, 2016, and June 30, 2015. We have provided an unmodified audit opinion on the Statement of Changes in Program Assets, which is presented on a cash basis.

Under the program, the State was authorized to issue \$386.9 million in revenue obligations to provide financing for payment of claims under the Petroleum Environmental Cleanup Fund Award (PECFA) program. As of June 30, 2016, a total of \$112.6 million in revenue obligations remained outstanding, including \$41.4 million in revenue bonds and \$71.2 million in commercial paper. In October 2016, the State issued refunding revenue bonds to fund the outstanding commercial paper.

The revenue obligations are not general obligation debt of the State. Instead, they are to be repaid primarily from the \$0.02 per gallon fee charged to suppliers of petroleum products received for sale in Wisconsin. These fees, which are collected by the Department of Revenue, totaled \$74.6 million in fiscal year 2015-16. Of this amount, \$28.7 million was retained by the program to pay principal and interest on outstanding obligations.

The remaining fees of \$45.9 million were deposited in the Petroleum Inspection Fund. Of this amount, \$5.2 million was used to pay PECFA claims; \$29.0 million was transferred to other funds, including \$27.3 million to the Transportation Fund as required by 2015 Wisconsin Act 55, the 2015-17 Biennial Budget Act; and \$11.7 million was used for other purposes. Transfers from the Petroleum Inspection Fund to other funds have occurred in each of the past twelve fiscal years.

2015 Wisconsin Act 55 sunsets the PECFA program. As of July 20, 2015, no new sites may be accepted into the program, but debt will remain outstanding until fully repaid. It is expected that the debt will be fully repaid in fiscal year 2019-20.

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

Respectfully submitted,

Joe Chrisman
State Auditor

JC/SH/cb

Audit Opinion ■



Independent Auditor's Report on the Financial Statement and Other Reporting Required by *Government Auditing Standards*

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Ms. Cathy Stepp, Secretary
Department of Natural Resources

Mr. Scott A. Neitzel, Secretary
Department of Administration

Report on the Financial Statement

We have audited the accompanying cash basis Statement of Changes in Program Assets and the related notes of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program as of and for the years ended June 30, 2016, and June 30, 2015.

Management's Responsibility for the Financial Statement

Management of the program is responsible for the preparation and fair presentation of the Statement of Changes in Program Assets in accordance with the cash basis of accounting described in Note 2 to the financial statement. This includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statement. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the Statement of Changes in Program Assets 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*, which is 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's

judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion on the Statement of Changes in Program Assets.

Opinion

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, 2016, and June 30, 2015, and the program's receipts and disbursements for the years then ended in accordance with the cash basis of accounting described in Note 2 to the financial statement.

Emphases of Matter

As discussed in Note 1 to the Statement of Changes in Program Assets, the financial statement 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 as of June 30, 2016, and June 30, 2015, the changes in its financial position, or where applicable, its cash flows for the year then ended.

As discussed in Note 2 to the Statement of Changes in Program Assets, and in order to provide a meaningful presentation to the 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 basis of accounting other than accounting principles generally accepted in the United States of America.

Our opinion is not modified with respect to either of these matters.

Other Matter

The Management's Discussion and Analysis on pages 9 through 12 is presented for the purposes of additional analysis and is not a required part of the financial statement. Such information has not been subjected to the auditing procedures applied in the audits of the financial statement and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated October 28, 2016, on our consideration of the program's internal control over financial reporting; our tests of its compliance with certain provisions of laws, regulations, and 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 used when considering the program's internal control over financial reporting and compliance.

LEGISLATIVE AUDIT BUREAU

A handwritten signature in black ink, appearing to read "Joe Chrisman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Joe Chrisman
State Auditor

October 28, 2016

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 year (FY) 2015-16 and FY 2014-15. 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 basis of accounting other than accounting principles generally accepted in the United States. Under the cash basis of accounting, receipts are reported when received and disbursements are reported when paid. The program's assets and activities are 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 for 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, 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 accounted for in the Petroleum Inspection Fund. The Building Commission may, from time to time, adopt supplemental resolutions authorizing the issuance of revenue refunding obligations and, subject to legislative authorization, additional revenue obligations for the purpose for which the program was created.

The State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program is administered jointly by the Wisconsin Department of Natural Resources and the Wisconsin Department of Administration.

The program resolution establishes special trust funds and accounts, and establishes the 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 Mellon Trust Company N.A. 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.

As shown in Table A, the program's assets were \$30.1 million as of June 30, 2016, \$30.7 million as of June 30, 2015, and \$30.2 million as of June 30, 2014.

Table A

Program Assets

| | June 30, 2016 | June 30, 2015 | Percentage Change 2015 to 2016 | June 30, 2014 | Percentage Change 2014 to 2015 |
|----------------------------------|---------------------|---------------------|--|---------------------|--|
| Restricted for Debt Service | \$30,071,234 | \$30,680,017 | (2.0)% | \$30,139,732 | 1.8% |
| Restricted for Other Purposes | 3,008 | 3,000 | 0.3 | 17,609 | (83.0) |
| Total Program Assets | \$30,074,242 | \$30,683,017 | (2.0) | \$30,157,341 | 1.7 |

Program assets restricted for debt service are available for the payment of principal and interest on revenue obligations and may be invested in direct obligations of the United States or held in demand deposit accounts. All program assets as of June 30, 2016, June 30, 2015, and June 30, 2014, including those restricted for debt service and for other purposes, were held in demand deposit accounts. As of June 30, 2016, June 30, 2015, and June 30, 2014, program assets restricted for debt service remained consistent, as the balances were primarily used to pay debt service payments scheduled for July 1, 2016, July 1, 2015, and July 1, 2014. These debt service payments included both principal and interest due on the 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds.

The program's revenue obligations were issued pursuant to subch. II of ch. 18, Wis. Stats.; s. 292.63 (9m), Wis. Stats.; and the program resolution and supplemental resolutions adopted by the State of Wisconsin Building Commission. The revenue obligations are not general obligations of the State of Wisconsin. They are payable from, and primarily secured by, petroleum inspection fees charged to suppliers of petroleum products received for sale in Wisconsin. These fees are subsequently transferred to and received by the trustee. The fee amount imposed under s. 168.12 (1), Wis. Stats., has been \$0.02 per gallon since April 2006.

Wisconsin Statutes authorize the program to issue revenue obligations not to exceed \$386,924,000 in principal amount, excluding any obligations that have been defeased under a cash optimization program administered by the Building Commission. As of June 30, 2016, all statutorily authorized revenue obligations have been issued in the form of revenue bonds and extendible municipal commercial paper. In addition to this limit on principal amount, the Building Commission may authorize the issuance of an unlimited amount of additional revenue obligations to fund or refund outstanding revenue obligations, pay issuance and administrative costs, make any necessary deposits to reserve funds, or pay accrued or capitalized interest.

On October 20, 2009, the State issued the 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds in the amount of \$117.5 million. The first principal payment on this issue was made on July 1, 2013. In addition, only interest has been paid on the extendible municipal commercial paper since December 11, 2009. As of June 30, 2016, revenue obligations outstanding totaled \$112.6 million and consisted of \$41.4 million in senior revenue bonds and \$71.2 million in junior extendible municipal commercial paper.

On October 13, 2016, the state issued 2016 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds in the amount of \$62.7 million. The proceeds of this issue are being used, along with other funds on deposit with the trustee, to fund all outstanding extendible municipal commercial paper.

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, excluding amounts related to bond refundings, was 2.55 in FY 2015-16 and 2.74 in FY 2014-15. The FY 2015-16 debt service coverage ratio

was calculated based on \$74,638,566 in petroleum inspection fees remitted by the State to the trustee, and senior debt service payments of \$29,298,334. In FY 2014-15, the calculated ratio was based on \$80,226,963 in petroleum inspection fees remitted by the State to the trustee, and senior debt service payments of \$29,240,160.

Petroleum inspection fees not retained by the trustee for debt service and certain other costs are transferred from the trustee to the State. Petroleum inspection fee revenue, up to the amount authorized by statute, may be used to pay PECFA claims, PECFA administrative costs, and other costs and transfers, including optional transfers to the trustee for early redemption of revenue obligations. Petroleum inspection fees transferred to the State were \$45.9 million in FY 2015-16, \$50.4 million in FY 2014-15, and \$41.2 million in FY 2013-14, as shown in Table B.

Table B

Petroleum Inspection Fees

| | FY 2015-16 | FY 2014-15 | Percentage Change FY 2014-15 to FY 2015-16 | FY 2013-14 | Percentage Change FY 2013-14 to FY 2014-15 |
|--|---------------------|---------------------|---|---------------------|---|
| Petroleum Inspection Fees Remitted by the State to the Trustee | \$74,638,566 | \$80,226,963 | (7.0)% | \$71,206,010 | 12.7% |
| Petroleum Inspection Fees Retained by the Trustee | 28,744,220 | 29,824,161 | (3.6) | 29,969,491 | (0.5) |
| Petroleum Inspection Fees Transferred from the Trustee to the State | \$45,894,346 | \$50,402,802 | (8.9) | \$41,236,519 | 22.2 |

During FY 2015-16, claims paid from the petroleum inspection fees transferred to the State totaled \$5.2 million, which represents an increase of 36.8 percent from the \$3.8 million in claims paid from fees in FY 2014-15. No claims were paid from the proceeds of revenue obligations and any related interest and investment income during FY 2015-16, FY 2014-15, and FY 2013-14. All submitted claims had been reviewed and approved as of June 30, 2016.

A provision of 2015 Wisconsin Act 55, the 2015-17 Biennial Budget Act, sunsets the PECFA program. Landowners and others were required to notify the Department of Natural Resources of the potential for a PECFA cleanup site claim by July 20, 2015. All claims for reimbursement of cleanup costs must be submitted before July 1, 2020.



Financial Statement ■

Statement of Changes in Program Assets for the Fiscal Years Ended June 30, 2016, and June 30, 2015

| | Fiscal Year 2015-16 | Fiscal Year 2014-15 |
|---|----------------------|----------------------|
| Program Assets, July 1 | \$ 30,683,017 | \$ 30,157,341 |
| RECEIPTS | | |
| Net Proceeds from Sale of Revenue Refunding Obligations | 0 | 0 |
| Petroleum Inspection Fees Remitted by the State of Wisconsin to the Trustee | \$ 74,638,566 | \$ 80,226,963 |
| Less: Petroleum Inspection Fees Transferred from the Trustee to the State of Wisconsin Petroleum Inspection Fund (see Note 7) | (45,894,346) | (50,402,802) |
| Petroleum Inspection Fees Retained by the Trustee | 28,744,220 | 29,824,161 |
| Interest and Investment Income | 1,684 | 1,634 |
| Total Receipts | 28,745,904 | 29,825,796 |
| TOTAL PROGRAM ASSETS AVAILABLE | 59,428,921 | 59,983,137 |
| DISBURSEMENTS | | |
| Transfers of Proceeds from Sale of Revenue Obligations and Interest and Investment Income to the State of Wisconsin Petroleum Inspection Fund | 0 | 0 |
| Debt Service (see Notes 5 and 8): | | |
| Senior Debt Service—Bond Principal | 26,540,000 | 25,345,000 |
| Senior Debt Service—Bond Interest | 2,588,488 | 3,817,200 |
| Senior Debt Service—Commercial Paper Interest | 169,846 | 77,960 |
| Junior Subordinate Debt Service—Commercial Paper Principal | 0 | 0 |
| Total Debt Service | 29,298,334 | 29,240,160 |
| Debt Issuance Costs | 0 | 0 |
| Other Costs | 56,345 | 59,960 |
| Total Disbursements | 29,354,679 | 29,300,120 |
| Program Assets Restricted for: | | |
| Debt Service (see Note 4) | 30,071,234 | 30,680,017 |
| Other Purposes (see Note 4) | 3,008 | 3,000 |
| PROGRAM ASSETS, JUNE 30 | \$ 30,074,242 | \$ 30,683,017 |

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, 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. The program is administered jointly by the Wisconsin Department of Natural Resources and the Wisconsin Department of Administration.

Pursuant to the program resolution, the Building Commission may occasionally adopt supplemental resolutions authorizing the issuance of revenue obligations up to the aggregate amount authorized by Wisconsin Statutes. As of June 30, 2016, all statutorily authorized revenue obligations have been issued. In addition, the Building Commission may occasionally adopt supplemental resolutions authorizing the issuance of an unlimited amount of revenue refunding obligations.

The program resolution establishes special trust funds and accounts, and establishes the 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 Mellon Trust Company N.A. 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 Mellon Trust Company N.A. is also the registrar for the revenue obligations.

The Bank of New York Mellon Trust Company N.A. is the issuing and paying agent for the revenue bonds. U.S. Bank National Association is the issuing and paying agent for the extendible municipal commercial paper.

When issued, proceeds from revenue bonds and extendible municipal commercial paper proceeds are held by the trustee until the Department of Natural Resources and the Department of Administration request the specific amounts be remitted to the State to pay PECFA claims. Petroleum inspection fee revenue obligations are payable from, and primarily secured by, petroleum inspection fees that result from a \$0.02 per gallon fee authorized in s. 168.12 (1), Wis. Stats., and imposed on suppliers of petroleum products received for sale in Wisconsin. Petroleum inspection fees are paid monthly by suppliers to the Wisconsin Department of Revenue, which subsequently forwards them to the program's trustee.

All revenues and assets of the Petroleum Inspection Fee Revenue Obligations Program are initially restricted for the purposes provided by the program resolution under which the revenue obligations are issued. The fees in excess of the amounts needed to meet debt service requirements and pay program administrative costs are transferred from the trustee to the State of Wisconsin Petroleum Inspection Fund. Subject to appropriation, the State uses the transferred fees to pay PECFA claims, PECFA program administrative costs, and other costs and transfers. In addition, an appropriation exists for the optional transfer of excess petroleum inspection fees to the trustee for early redemption of revenue obligations.

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 basis of accounting other than accounting principles generally accepted in the United States. Under the cash basis of accounting, receipts are reported when received and disbursements are reported when paid. The program's assets may include cash, consisting of demand deposits held by the Bank of New York Mellon Trust Company N.A. and U.S. Bank National Association, and investments valued at historical cost. The program's assets and activities are 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 is authorized by Wisconsin Statutes and the program resolution to deposit funds with the trustee and the extendible municipal commercial paper issuing and paying agent. The program is also authorized by Wisconsin Statutes and the program resolution to invest funds restricted for debt service in direct obligations of the United States. Under s. 25.17 (3) (b), Wis. Stats., and as permitted by the program resolution, the program is authorized to invest funds not restricted for debt service in direct obligations of the United States, high-quality corporate commercial paper, certificates of deposit, and other investments.

Custodial credit risk for deposits is the risk that, in the event of the failure of a financial institution, the deposits may not be returned. As of June 30, 2016, the demand deposit accounts with the trustee and the extendible municipal commercial paper issuing and paying agent totaled \$30,074,242. As of June 30, 2015, the demand deposit accounts with the trustee and the extendible municipal commercial paper issuing and paying agent totaled \$30,683,017. As of June 30, 2016, \$354,223 was insured against loss by the Federal Deposit Insurance Corporation (FDIC). The remaining balance of \$29,720,019 as of June 30, 2016, was not insured or collateralized. As of June 30, 2015, \$298,038 was insured against loss by the FDIC. The remaining balance of \$30,384,979 as of June 30, 2015, was not insured or collateralized.

Custodial credit risk for investments is the risk that, in the event of failure of a counterparty to a transaction, the program will not be able to recover the value of the investments that are in the possession of another party. As of June 30, 2016, and June 30, 2015, the program did not hold any investments and, therefore, was not exposed to custodial credit risk for investments at the end of either fiscal year.

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Under the program resolution, the program is generally permitted to make investments with maturities of one year or less. As of June 30, 2016, and June 30, 2015, the program did not hold any investments and, therefore, was not subject to interest rate risk at the end of either fiscal year.

The program does not have a specific policy related to custodial credit risk or interest rate risk.

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 agent are reported as program assets restricted for debt service. Program assets in excess of those restricted for debt service are available for other uses as outlined in the program resolution.

As of June 30, 2016, the program's assets totaled \$30,074,242. Of this amount, \$30,071,234, consisting of demand deposits, was restricted for debt service. The remaining \$3,008, consisting of demand deposits, was restricted for transfer to the State of Wisconsin Petroleum Inspection Fund or to pay debt issuance costs or administrative costs of the program.

As of June 30, 2015, the program's assets totaled \$30,683,017. Of this amount, \$30,680,017, consisting of demand deposits, was restricted for debt service. The remaining \$3,000, consisting of demand deposits, was restricted for transfer to the State of Wisconsin Petroleum Inspection Fund or to pay debt issuance costs or administrative costs of the program.

5. REVENUE BONDS AND EXTENDIBLE MUNICIPAL COMMERCIAL PAPER

The program's revenue obligations are issued pursuant to subch. II of ch. 18, Wis. Stats.; s. 292.63 (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 petroleum products received for sale in Wisconsin (see also Note 7). The revenue obligations are not general obligations of the State.

The program's revenue obligations may include extendible municipal commercial paper, which may have original maturities from 1 to 180 days, is not callable prior to the original maturity date, and bears interest from the date of issuance at the rate determined on the date of issuance. The State expects to pay the principal of the extendible municipal commercial paper on the original maturity date with the proceeds from issuance of additional extendible municipal commercial paper or other means. If the principal of the extendible municipal commercial paper is not paid off on the original maturity date, the State, under certain circumstances, may exercise the option to extend the maturity date. In such an event, the maturity date is extended to a date that is 270 days after the original issue date. Interest is then due on the first business day of either the first or second month after the original maturity date and then on a monthly basis and on any redemption date or the extended maturity date. In addition, principal and interest on the extendible municipal commercial paper may be payable from issuance of additional revenue obligations in the form of bonds that have been authorized to refund the commercial paper or any other funds made available by the State for this purpose.

Interest payments on extendible municipal commercial paper are on 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.

During the fiscal years ended June 30, 2015, and June 30, 2016, the following changes occurred in revenue bonds outstanding:

Change in Revenue Bonds Outstanding

| <u>Fiscal Year</u> | <u>Balance July 1</u> | <u>Bonds Issued</u> | <u>Principal Redeemed</u> | <u>Balance June 30</u> |
|--------------------|-----------------------|---------------------|---------------------------|------------------------|
| 2014-15 | \$93,295,000 | \$0 | \$25,345,000 | \$67,950,000 |
| 2015-16 | 67,950,000 | 0 | 26,540,000 | 41,410,000 |

The senior revenue bonds issued by the program and outstanding as of June 30, 2016, were as follows:

Senior Revenue Bonds

| <u>Date Issued</u> | <u>Series</u> | <u>Interest Rates</u> | <u>Maturity Through</u> | <u>First Optional Redemption Date</u> | <u>Amount Issued</u> | <u>June 30, 2016 Amount Outstanding</u> |
|----------------------------|---------------|-----------------------|-------------------------|---------------------------------------|----------------------|---|
| 10/20/2009 | 2009 Series 1 | 3.0 to 5.0% | 7/1/2017 | Not Callable | <u>\$117,460,000</u> | <u>\$41,410,000</u> |
| Total Senior Revenue Bonds | | | | | \$117,460,000 | \$41,410,000 |

The 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds are not subject to redemption prior to maturity.

The program's future debt service requirements as of June 30, 2016, for principal and interest for the 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds are as shown in the following table.

Future Debt Service on Revenue Bonds

| <u>Fiscal Year Ending June 30</u> | <u>Principal Amount</u> | <u>Interest Amount</u> | <u>Total Debt Service on Bonds</u> |
|-----------------------------------|-------------------------|------------------------|------------------------------------|
| 2017 | \$27,800,000 | \$1,269,700 | \$29,069,700 |
| 2018 | <u>13,610,000</u> | <u>290,050</u> | <u>13,900,050</u> |
| | \$41,410,000 | \$1,559,750 | \$42,969,750 |

The following table presents the extendible municipal commercial paper activity for FY 2014-15 and FY 2015-16.

Change in Extendible Municipal Commercial Paper Outstanding

| <u>Fiscal Year</u> | <u>Balance July 1</u> | <u>Commercial Paper Issued</u> | <u>Principal Repaid</u> | <u>Balance June 30</u> |
|--------------------|-----------------------|--------------------------------|-------------------------|------------------------|
| 2014-15 | \$71,150,000 | \$0 | \$0 | \$71,150,000 |
| 2015-16 | 71,150,000 | 0 | 0 | 71,150,000 |

As of June 30, 2016, the \$71,150,000 in outstanding extendible municipal commercial paper had interest rates ranging from 0.55 percent to 0.63 percent, and maturities ranging from July 6, 2016, to July 25, 2016. As of June 30, 2015, the \$71,150,000 in outstanding extendible municipal commercial paper had interest rates ranging from 0.11 percent to 0.18 percent, and maturities ranging from August 12, 2015, to September 17, 2015.

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, additional legislative authorization is provided and 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 take-out capacity” and “variable-rate debt exposure.” Variable-rate take-out 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 2015-16 and FY 2014-15. 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 take-out capacity, the State needed to take no further action. For June 2016, the program’s variable-rate take-out capacity was calculated to be \$391,698,779, which was \$320,548,779 higher than the variable-rate debt exposure of \$71,150,000. For June 2015, the program’s variable-rate take-out capacity was calculated to be \$349,653,099, which was \$278,503,099 higher than the variable-rate debt exposure of \$71,150,000.

On November 23, 2010, Moody’s Investors Service affirmed its rating on the State’s petroleum inspection fee revenue bonds at “Aa2.” On March 15, 2016, Standard & Poor’s Ratings Services affirmed its rating on the State’s petroleum inspection fee revenue bonds at “AA.” On May 4, 2015, Fitch Ratings affirmed its rating on the State’s petroleum inspection fee revenue bonds at “AA.” One

of the rationales cited by Fitch Ratings for the affirmation of its rating was that inspection fees have consistently provided satisfactory coverage of debt service.

6. DEBT AUTHORITY FOR THE PROGRAM

Wisconsin Statutes authorize the program to issue revenue obligations not to exceed \$386,924,000 in principal amount, excluding any obligations that have been defeased under a cash optimization program administered by the Building Commission. As of June 30, 2016, the balance of statutorily authorized revenue obligations has been issued. In addition to this limit on principal amount, the Building Commission may authorize the issuance of an unlimited amount of additional revenue obligations to fund or refund outstanding revenue obligations, to pay issuance and administrative costs, to make any necessary deposits to reserve funds, or to pay accrued or capitalized interest.

7. PETROLEUM INSPECTION FEES

Petroleum inspection fees result from the fees imposed under s. 168.12 (1), Wis. Stats., and other payments received under s. 292.63 (4) (h) 1m. and (5) (a) and (c), Wis. Stats. Under s. 168.12 (1), Wis. Stats., a \$0.02 per gallon fee is imposed by the State on suppliers of petroleum products received for sale in Wisconsin. The per gallon fees are paid to the State of Wisconsin Department of Revenue by suppliers, along with motor fuel taxes, and are initially deposited into the Transportation Fund. The Department of Revenue determines the amount collected for the per gallon fees and remits it to the program's trustee on a monthly basis. The trustee transfers petroleum inspection fees in excess of the amount needed to meet debt service requirements and to pay administrative costs of the Petroleum Inspection Fee Revenue Obligations Program to the State of Wisconsin Petroleum Inspection Fund, free of the first lien pledge of the program resolution. The State uses the fees transferred to the State of Wisconsin Petroleum Inspection Fund to pay PECFA claims, PECFA program administrative costs, and other costs and transfers, including optional transfers to the trustee to redeem revenue obligations.

The other petroleum inspection fees that are pledged currently consist of penalty payments made under s. 292.63 (4) (h) 1m., Wis. Stats., by consultants for submitting claims for ineligible costs; proceeds under s. 292.63 (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. 292.63 (5) (c), Wis. Stats., related to the Wisconsin Attorney General's actions against fraudulent claims. In FY 2015-16, these other petroleum inspection fees totaled \$52,880 and were made available to the trustee. In FY 2014-15, these other petroleum inspection fees totaled \$47,245 and were made available to the trustee. These fees were not transferred to the trustee in either fiscal year because the trustee indicated that no deficiencies that would require the transfer of the fees existed in any of the program's accounts held by the trustee as of June 30, 2016, or June 30, 2015.

The two tables that follow show the amounts of petroleum inspection fees that were remitted by the State of 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 during FY 2015-16 and FY 2014-15.

FY 2015-16

| <u>Month</u> | <u>Petroleum Inspection Fees Remitted by the State to the Trustee</u> | <u>Petroleum Inspection Fees Retained by the Trustee</u> | <u>Petroleum Inspection Fees Transferred by the Trustee to the State</u> |
|------------------|---|--|--|
| July 2015 | \$ 5,413,617 | \$ 2,493,942 | \$ 2,919,675 |
| August | 9,030,319 | 2,500,041 | 6,530,278 |
| September | 4,174,316 | 2,500,241 | 1,674,075 |
| October | 6,842,183 | 2,508,755 | 4,333,428 |
| November | 6,531,668 | 2,481,192 | 4,050,476 |
| December | 7,813,848 | 2,479,942 | 5,333,906 |
| January 2016 | 5,952,526 | 2,493,392 | 3,459,134 |
| February | 6,116,227 | 2,496,942 | 3,619,285 |
| March | 6,072,417 | 2,496,942 | 3,575,475 |
| April | 4,146,226 | 2,511,131 | 1,635,095 |
| May | 6,795,908 | 2,540,192 | 4,255,716 |
| June | <u>5,749,311</u> | <u>1,241,508</u> | <u>4,507,803</u> |
| Total FY 2015-16 | <u>\$74,638,566</u> | <u>\$28,744,220</u> | <u>\$45,894,346</u> |

FY 2014-15

| <u>Month</u> | <u>Petroleum Inspection Fees Remitted by the State to the Trustee</u> | <u>Petroleum Inspection Fees Retained by the Trustee</u> | <u>Petroleum Inspection Fees Transferred by the Trustee to the State</u> |
|------------------|---|--|--|
| July 2014 | \$ 4,406,612 | \$ 2,482,806 | \$ 1,923,806 |
| August | 14,808,227 | 2,479,806 | 12,328,421 |
| September | 5,487,986 | 2,481,107 | 3,006,879 |
| October | 7,291,041 | 2,492,906 | 4,798,135 |
| November | 4,395,449 | 2,484,446 | 1,911,003 |
| December | 6,364,197 | 2,485,047 | 3,879,150 |
| January 2015 | 5,666,838 | 2,498,806 | 3,168,032 |
| February | 6,785,911 | 2,482,806 | 4,303,105 |
| March | 6,003,349 | 2,482,806 | 3,520,543 |
| April | 8,047,198 | 2,492,627 | 5,554,571 |
| May | 3,502,695 | 2,481,056 | 1,021,639 |
| June | <u>7,467,460</u> | <u>2,479,942</u> | <u>4,987,518</u> |
| Total FY 2014-15 | <u>\$80,226,963</u> | <u>\$29,824,161</u> | <u>\$50,402,802</u> |

8. 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 2015-16 and FY 2014-15 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, excluding amounts related to bond refundings.

Debt Service Coverage Ratio for Senior Debt

| | <u>Fiscal Year 2015-16</u> | <u>Fiscal Year 2014-15</u> |
|---|----------------------------|----------------------------|
| Fees Remitted to the Trustee | \$74,638,566 | \$80,226,963 |
| Senior Debt Service: | | |
| Principal—Bonds | \$26,540,000 | \$25,345,000 |
| Interest—Bonds | 2,588,488 | 3,817,200 |
| Interest—Commercial Paper | <u>169,846</u> | <u>77,960</u> |
| Total Senior Debt Service | \$29,298,334 | \$29,240,160 |
| Debt Service Coverage Ratio for Senior Debt | 2.55 | 2.74 |

9. 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 them. While the original backlog has been eliminated, PECFA claims continue to be submitted to the State.

2015 Wisconsin Act 55, the 2015-17 Biennial Budget Act, sunsets the PECFA program. Landowners and others were required to notify the Department of Natural Resources of the potential for a PECFA cleanup site claim by July 20, 2015. All claims for reimbursement of cleanup costs must be submitted before July 1, 2020. PECFA claims paid were \$5.2 million in FY 2015-16 and were \$3.8 million in FY 2014-15.

10. SUBSEQUENT EVENT

On October 13, 2016, the State issued 2016 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds in the amount of \$62,670,000. Interest rates range from 4.0 to 5.0 percent, with interest payments payable semiannually beginning July 1, 2017. The bonds mature on July 1 of the years 2017 through 2019.

The proceeds of this issue are being used, along with petroleum inspection fees on deposit with the trustee, to fund all outstanding Petroleum Inspection Fee Revenue Extendible Municipal Commercial Paper previously issued to pay soil and groundwater remediation costs under the PECFA program.

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Auditor's Report ■



Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee

Ms. Cathy Stepp, Secretary
Department of Natural Resources

Mr. Scott A. Neitzel, Secretary
Department of Administration

We have audited the cash basis Statement of Changes in Program Assets and the related notes of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program as of and for the years ended June 30, 2016, and June 30, 2015, and have issued our report thereon dated October 28, 2016. 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*, which is issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the program is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audits of the Statement of Change in Program Assets, we considered the program's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the program's internal control. Accordingly, we do not express an opinion on the effectiveness of the program's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent misstatements, or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the program's financial statement will not be prevented, or that a material misstatement will not be detected and corrected on a timely

basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the program's financial statement is free from 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering the program's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the program's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU



Joe Chrisman
State Auditor

October 28, 2016