

**Report 11-12
November 2011**

An Audit

Petroleum Inspection Fee Revenue Obligations Program

2011-2012 Joint Legislative Audit Committee Members

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State Auditor – Joe Chrisman

Audit Prepared by

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Joe Chrisman
State Auditor

November 17, 2011

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 Safety and Professional Services and the Department of Administration, and in accordance with s. 13.94(1s), Wis. Stats., we have completed a financial audit of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program for the fiscal years ending June 30, 2011, and June 30, 2010. We have provided our unqualified audit opinion on the Statement of Changes in Program Assets. The Department of Safety and Professional Services' responsibilities related to this program were performed by the former Department of Commerce through the end of fiscal year (FY) 2010-11.

Under the program, the State was authorized to issue \$386.9 million in revenue bonds and commercial paper to provide financing for payment of claims under the Petroleum Environmental Cleanup Fund Award (PECFA) program. These 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 sold in Wisconsin. As of June 30, 2011, a total of \$188.7 million in revenue obligations remained outstanding, including \$117.5 million in revenue bonds and \$71.2 million in commercial paper.

The State collected \$73.8 million in petroleum inspection fees during FY 2010-11. Because the State refinanced a portion of the program's outstanding revenue obligations during FY 2009-10, only \$5.9 million of the inspection fees needed to be retained by the program for debt service and other costs during FY 2010-11. This allowed \$67.9 million of inspection fees to be deposited to the Petroleum Inspection Fund, of which \$8.8 million was used to pay PECFA claims. The remaining \$59.1 million was used for a variety of purposes, including transfers authorized in 2009 Wisconsin Act 28 of \$24.1 million to the Transportation Fund and \$9.2 million to the General Fund. In addition, \$4.8 million was transferred to the General Fund to meet lapse requirements under 2009 Wisconsin Acts 2 and 28.

2011 Wisconsin Act 32, the 2011-13 Biennial Budget Act, authorized the transfer of \$25.8 million from the Petroleum Inspection Fund to the Transportation Fund during each year of the 2011-13 biennium. To ensure funding is available for these transfers, the spending authority in the appropriation used to pay PECFA claims was reduced from \$9.1 million for FY 2010-11 to \$4.6 million for each year of the 2011-13 biennium. A balance is expected to remain in the fund through the biennium. However, if PECFA claims exceed the amounts appropriated, a backlog will likely develop and related interest costs will be incurred. The Department of Safety and Professional Services indicated that it may seek increased appropriation authority to avoid a backlog.

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

Respectfully submitted,


Joe Chrisman
State Auditor

JC/BN/ss

Audit Opinion ■

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

We have audited the accompanying Statement of Changes in Program Assets of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program for the years ended June 30, 2011, and June 30, 2010. This financial statement is the responsibility of the program's management. Our responsibility is to express an opinion on the financial statement based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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 audits provide a reasonable basis for our opinion.

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

4 AUDIT OPINION

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

In our opinion, the Statement of Changes in Program Assets presents fairly, in all material respects, the Petroleum Inspection Fee Revenue Obligations Program's assets as of June 30, 2011, and June 30, 2010, and the program's receipts and disbursements for the years then ended, on the cash basis of accounting.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 11, 2011, 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 considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the Statement of Changes in Program Assets of the Petroleum Inspection Fee Revenue Obligations Program. The supplementary information included as Management's Discussion and Analysis on pages 5 through 9 is presented for purposes of additional analysis and is not a required part of the financial statement. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

November 11, 2011

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Deputy State Auditor for Financial Audit

Management's Discussion and Analysis ■

Prepared by Management of the Petroleum Inspection Fee Revenue Obligations Program

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

Overview of the Statement of Changes in Program Assets

The Statement of Changes in Program Assets of the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program is intended to show the changes in the program's assets for fiscal years (FYs) 2010-11 and 2009-10. Accounting for the program is done outside the State of Wisconsin's central accounting system.

The Statement of Changes in Program Assets presents the program's receipts and disbursements on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States. Under the cash basis of accounting, receipts are reported when received and disbursements are reported when paid. Both the financial position and the activity of the program 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.

The Wisconsin Department of Safety and Professional Services was created as part of the 2011-13 biennial budget (2011 Wisconsin Act 32) and, effective July 1, 2011, administers the PECFA program. In addition, effective July 1, 2011, the Department of Safety and Professional Services and the Department of Administration jointly administer the Petroleum Inspection Fee Revenue Obligations Program. The Wisconsin Department of Commerce, which was eliminated as part of the 2011-13 biennial budget, was involved in the administration of the Petroleum Inspection Fee Revenue Obligations Program and PECFA program during FY 2009-10 and FY 2010-11.

The program resolution establishes special trust funds and accounts and fiduciary responsibilities that are to be undertaken by a trustee for the benefit of the bondholders, extendible municipal commercial paper noteholders, and holders of any other obligations that may be issued. The Bank of New York 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 \$27.2 million as of June 30, 2009, \$4.5 million as of June 30, 2010, and \$3.3 million as of June 30, 2011. Under the newly implemented Governmental Accounting Standards Board Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, program assets formerly reported as reserved for debt service are now reported as restricted for debt service and program assets formerly reported as unreserved are now reported as restricted for other purposes.

Table A

Program Assets

	June 30, 2011	June 30, 2010	Percentage Change, 2010 to 2011	June 30, 2009	Percentage Change, 2009 to 2010
Restricted for Debt Service	\$3,346,690	\$4,519,896	(26.0)%	\$ 27,244,422	(83.4)%
Restricted for Other Purposes	3,007	5,474	(45.1)	2,642	107.2
Total Program Assets	<u>\$3,349,697</u>	<u>\$4,525,370</u>	(26.0)	<u>\$27,247,064</u>	(83.4)

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. At June 30, 2011, 2010, and 2009, all program assets, including those restricted for debt service and for other purposes, were held in demand deposit accounts. From June 30, 2010, to June 30, 2011, program assets restricted for debt service showed a net decrease of 26.0 percent. From June 30, 2009, to June 30, 2010, program assets restricted for debt service showed a net decrease of 83.4 percent. The majority of the balances shown as of June 30 are used to pay the debt service payments scheduled for the following day on July 1. As discussed in more detail later, in October 2009, the State issued revenue refunding bonds to redeem the program's other bonds outstanding at that time. The balance of program assets restricted for debt service as of June 30, 2011, and June 30, 2010, was significantly lower than the balance as of June 30, 2009, because the debt service payments made on July 1, 2011, and July 1, 2010, for the October 2009 issue were for interest only and, therefore, were lower than the debt service payments made on July 1, 2009, which included both principal and interest for the bonds outstanding at that time.

The program's revenue obligations are issued pursuant to subchapter II of ch. 18, Wis. Stats.; s. 101.143(9m), Wis. Stats.; and the program resolution and supplemental resolutions adopted by the State of Wisconsin Building Commission. The revenue obligations are 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 and 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. At this time, 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 issue 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 July 1, 2009, the program made its scheduled debt service payment, which included a revenue bond principal payment of \$22.3 million. On October 20, 2009, the State issued 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds in the amount of \$117.5 million. On November 9, 2009, some of the proceeds from this issue, which included an original issue premium of \$14.3 million, were used, along with other funds on deposit with the program trustee, to redeem early the remaining \$19.0 million of outstanding 2004 Series A Petroleum Inspection Fee Revenue Bonds and the remaining \$47.4 million of outstanding 2004 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds. These bonds were redeemed at 102 percent of their face value, resulting in a total redemption premium of \$1,327,800. Accrued interest on the early redemptions totaled \$1,089,280. A portion of the proceeds of the 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds was also used to fund \$71,150,000 of the \$142,300,000 in outstanding extendible municipal commercial paper between October 20, 2009, and December 11, 2009.

The FY 2010-11 debt service payments for the 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds consisted only of interest. The first principal payment on this issue comes due in FY 2013-14. In addition, only interest has been paid on the extendible municipal commercial paper since December 11, 2009. As of June 30, 2011 and 2010, revenue obligations outstanding totaled \$188.7 million and consisted of \$117.5 million in revenue bonds and \$71,150,000 in 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 10.57 in FY 2010-11 and 2.90 in FY 2009-10. The FY 2010-11 debt service coverage ratio was calculated based on \$73,808,676 in petroleum inspection fees remitted by the State to the trustee, and senior debt service payments of \$6,985,489. In FY 2009-10, the calculated ratio was based on \$72,540,493 in petroleum inspection fees remitted by the State to the trustee, and senior debt service payments of \$24,982,406.

Petroleum inspection fees not retained by the trustee for debt service are transferred by the trustee to the State. Petroleum inspection fee revenue, up to the amount authorized by statute, is 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 \$67.9 million in FY 2010-11, \$61.3 million in FY 2009-10, and \$45.0 million in FY 2008-09, as shown in Table B. As discussed previously, in October 2009 the State issued revenue refunding bonds for early redemption of the program's other outstanding bond issues. The scheduled debt service payments on

the October 2009 issue are for interest only until FY 2013-14. As a result, fewer petroleum inspection fees needed to be retained by the trustee during FY 2010-11 and FY 2009-10 for debt service payments and, therefore, more funds were available for transfer to the State.

Table B
Petroleum Inspection Fees

	FY 2010-11	FY 2009-10	Percentage Change, FY 2009-10 to FY 2010-11	FY 2008-09	Percentage Change, FY 2008-09 to FY 2009-10
Petroleum Inspection Fees Remitted by the State to the Trustee	\$73,808,676	\$72,540,493	1.7%	\$73,358,641	(1.1)%
Petroleum Inspection Fees Retained by the Trustee	5,868,194	11,196,056	(47.6)	28,341,339	(60.5)
Petroleum Inspection Fees Transferred by the Trustee to the State	<u>\$67,940,482</u>	<u>\$61,344,437</u>	10.8	<u>\$45,017,302</u>	36.3

During FY 2010-11, claims totaling \$8.8 million were paid from petroleum inspection fees transferred to the State. This amount represents a decrease of 7.4 percent from the \$9.5 million in claims paid from fees in FY 2009-10. During FY 2009-10, claims paid from fees decreased 8.7 percent from the \$10.4 million paid in FY 2008-09. Both decreases resulted from the identification of fewer new sites needing cleanup and from decreases in the average dollar value of claims. No claims were paid from the proceeds of revenue obligations and any related interest and investment income during FYs 2010-11, 2009-10, and 2008-09.

As of June 30, 2011, approved but unpaid claims totaled \$0.2 million, which is \$0.1 million more than approved but unpaid claims as of June 30, 2010. In addition, as of June 30, 2011, approximately \$1.2 million in claims submitted had yet to be both reviewed and approved. The Department of Safety and Professional Services estimates that approximately \$5.9 million in additional claims had not been submitted as of June 30, 2011, for costs that landowners had already incurred as of that date. In addition, the Department of Safety and Professional Services reports that as of June 30, 2011, there were no claimants appealing determinations on previously finalized claims.



Financial Statement ■

Statement of Changes in Program Assets for the Fiscal Years Ended June 30, 2011 and 2010

	Fiscal Year 2010-11	Fiscal Year 2009-10
Program Assets, July 1	\$ 4,525,370	\$ 27,247,064
RECEIPTS		
Net Proceeds from Sale of Revenue Refunding Obligations (see Note 6)	0	131,238,006
Petroleum Inspection Fees Remitted by the State of Wisconsin to the Trustee	\$ 73,808,676	\$ 72,540,493
Less: Petroleum Inspection Fees Transferred from the Trustee to the State of Wisconsin Petroleum Inspection Fund (see Note 8)	<u>(67,940,482)</u>	<u>(61,344,437)</u>
Petroleum Inspection Fees Retained by the Trustee	5,868,194	11,196,056
Interest and Investment Income	<u>279</u>	<u>8,654</u>
Total Receipts	<u>5,868,473</u>	<u>142,442,716</u>
TOTAL PROGRAM ASSETS AVAILABLE	<u>10,393,843</u>	<u>169,689,780</u>
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 9):		
Senior Debt Service—Bond Principal	0	88,740,000
Senior Debt Service—Bond Interest	6,700,374	3,179,830
Senior Debt Service—Commercial Paper Interest	285,115	541,856
Junior Subordinate Debt Service—Commercial Paper Principal	<u>0</u>	<u>71,150,000</u>
Total Debt Service	6,985,489	163,611,686
Debt Issuance Costs	0	137,673
Other Costs	<u>58,657</u>	<u>1,415,051</u>
Total Disbursements	<u>7,044,146</u>	<u>165,164,410</u>
Program Assets Restricted (see Note 4) for:		
Debt Service	3,346,690	4,519,896
Other Purposes	<u>3,007</u>	<u>5,474</u>
PROGRAM ASSETS, JUNE 30	<u>\$ 3,349,697</u>	<u>\$ 4,525,370</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

Effective July 1, 2011, the State of Wisconsin Petroleum Inspection Fee Revenue Obligations Program is administered jointly by the Wisconsin Department of Safety and Professional Services and the Wisconsin Department of Administration. The 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, which, effective July 1, 2011, is administered by the Wisconsin Department of Safety and Professional Services.

The 2011-13 biennial budget (2011 Wisconsin Act 32) resulted in the creation of the Wisconsin Department of Safety and Professional Services, effective July 1, 2011. The Wisconsin Department of Commerce, which was eliminated as part of the 2011-13 biennial budget, was involved in the administration of the Petroleum Inspection Fee Revenue Obligations Program and the PECFA program during FY 2009-10 and FY 2010-11.

Pursuant to the program resolution, the Building Commission may from time to time adopt supplemental resolutions authorizing the issuance of revenue obligations up to the aggregate amount authorized by Wisconsin Statutes. As of June 30, 2011, all statutorily authorized revenue obligations have been issued. In addition, the Building Commission may from time to time adopt supplemental resolutions authorizing the issuance of an unlimited amount of revenue refunding obligations.

The program resolution establishes special trust funds and accounts and fiduciary responsibilities that are to be undertaken by a trustee for the benefit of the bondholders, extendible municipal commercial paper noteholders, and holders of any other obligations that may be issued. The Bank of New York 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 Trust N.A. is the issuing and paying agent for the extendible municipal commercial paper.

When issued, revenue bond and extendible municipal commercial paper proceeds are held by the trustee until the Department of Safety and Professional Services 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 by the trustee to the State of Wisconsin Petroleum Inspection Fund. Subject to appropriation, the Department of Safety and Professional Services 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 comprehensive 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 Trust N.A., and investments valued at historical cost. The financial position and activity of the program is presented on the cash basis of accounting to provide a meaningful presentation to bondholders and extendible municipal commercial paper noteholders regarding resources available to pay debt service.

3. DEPOSITS AND INVESTMENTS

The program 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. In addition, 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 authorized under s. 25.17(3)(b), Wis. Stats., and permitted by the program resolution.

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, 2011, the demand deposit accounts with the trustee and the extendible municipal commercial paper issuing and paying agent totaled \$3,349,697. As of June 30, 2010, the demand deposit accounts with the trustee and the extendible municipal commercial paper issuing and paying agent totaled \$4,525,370. As of June 30, 2011, \$331,914 was insured against loss by the Federal Deposit Insurance Corporation (FDIC). The remaining balance of \$3,017,783 as of June 30, 2011, was not insured or collateralized. As of June 30, 2010, \$376,943 was insured against loss by the FDIC. The remaining balance of \$4,148,427 as of June 30, 2010, 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, 2011, and June 30, 2010, the program did not hold any investments and, therefore, it 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, 2011, and June 30, 2010, the program did not hold any investments and, therefore, it 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. The program assets accounts have been renamed to conform with the newly implemented Governmental Accounting Standards Board Statement Number 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

As of June 30, 2011, the program's assets totaled \$3,349,697. Of this amount, \$3,346,690, consisting of demand deposits, was restricted for debt service. The remaining \$3,007, 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, 2010, the program's assets totaled \$4,525,370. Of this amount, \$4,519,896, consisting of demand deposits, was restricted for debt service. The remaining \$5,474, 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 subchapter II of ch.18, Wis. Stats.; s. 101.143(9m), Wis. Stats.; and the program resolution and supplemental resolutions adopted by the State of Wisconsin Building Commission. The revenue obligations are payable from, and primarily secured by, petroleum inspection fees that suppliers are charged on petroleum products received for sale in Wisconsin (see also Note 8). The revenue obligations are not general obligations of the State.

The program's revenue obligations may include extendible municipal commercial paper, which may have maturities from 1 to 180 days, is not callable prior to maturity, and bears interest from date of issuance at the rate determined on the date of issuance. The principal of and interest on the extendible municipal commercial paper will be paid at the original maturity date unless the State exercises its option to extend the maturity date. In such an event, the maturity date is extended to a date that is up to 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, 2010, and June 30, 2011, 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>
2009-10	\$ 88,740,000	\$117,460,000	\$88,740,000	\$117,460,000
2010-11	117,460,000	0	0	117,460,000

In addition to the \$22.3 million in scheduled payments during FY 2009-10, on November 9, 2009, the State called the remaining \$19.0 million of the 2004 Series A Petroleum Inspection Fee Revenue Bonds and the remaining \$47.4 million of the 2004 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds for early redemption. These bonds had maturity dates on or after July 1, 2010, and were called at 102 percent of face value, resulting in a premium payment of \$1,327,800. The premium payment is included in other costs in the FY 2009-10 column of the financial statement. The bond calls were funded, in part, from a portion of the proceeds of the \$117.5 million of 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds issued by the program in October 2009 (see Note 6).

The senior revenue bonds issued by the program and outstanding as of June 30, 2011, 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, 2011 Amount Outstanding</u>
10/20/2009	2009 Series 1	2.5 to 5.0%	7/1/2017	Not Callable	<u>\$117,460,000</u>	<u>\$117,460,000</u>
Total Senior Revenue Bonds					\$117,460,000	\$117,460,000

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, 2011, 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>
2012	\$ 0	\$5,596,600	\$ 5,596,600
2013	0	5,596,600	5,596,600
2014	24,165,000	5,006,663	29,171,663
2015	25,345,000	3,817,200	29,162,200
2016	26,540,000	2,588,488	29,128,488
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>
	\$117,460,000	\$24,165,301	\$141,625,301

The following table presents the extendible municipal commercial paper activity for FYs 2009-10 and 2010-11.

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>
2009-10	\$142,300,000	\$0	\$71,150,000	\$71,150,000
2010-11	71,150,000	0	0	71,150,000

As noted previously, in October 2009, the State issued \$117.5 million of 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds. A portion of this issue was used to fund \$71,150,000 of the extendible municipal commercial paper during FY 2009-10.

As of June 30, 2011, the \$71,150,000 in outstanding extendible municipal commercial paper had interest rates ranging from 0.26 percent to 0.40 percent, and maturities ranging from July 11 to September 7, 2011. As of June 30, 2010, the \$71,150,000 in outstanding extendible municipal commercial paper had interest rates ranging from 0.38 percent to 0.44 percent, and maturities ranging from July 8 to September 10, 2010.

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." The

“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 2010-11 and FY 2009-10. 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 2011, the program’s variable-rate take-out capacity was calculated to be \$253,302,480, which was \$182,152,480 higher than the variable-rate debt exposure of \$71,150,000. For June 2010, the program’s variable-rate take-out capacity was calculated to be \$266,513,437, which was \$195,363,437 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 May 31, 2011, 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. CURRENT REFUNDING

On October 20, 2009, the program issued \$117,460,000 of 2009 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds. The net proceeds totaled \$131,238,006, including an original issue premium of \$14,320,139, less the underwriters’ discount of \$542,133. A portion of the bond proceeds was used on various dates in October through December 2009 to fund \$71,150,000 of previously issued extendible municipal commercial paper. The remaining portion of the bond proceeds, along with other cash already on deposit with the trustee, was used on November 9, 2009, to redeem the remaining \$18,960,000 of the program’s 2004 Series A Petroleum Inspection Fee Revenue Bonds and the remaining \$47,430,000 of the program’s 2004 Series 1 Petroleum Inspection Fee Revenue Refunding Bonds at a redemption price of 102 percent plus accrued interest to the date of redemption. As a result of this current refunding, the program effectively increased its aggregate debt service payments by \$1.9 million over the life of the refunding bonds and obtained an economic gain of \$1.1 million. This analysis does not address or include the bond proceeds used to fund previously issued extendible municipal commercial paper.

7. DEBT AUTHORITY FOR THE PROGRAM

Wisconsin Statutes, as amended by 2007 Wisconsin Act 20, 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. To date, the balance of statutorily authorized revenue obligations has been issued. In addition to this limit on principal amount, the Building Commission may issue 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.

8. PETROLEUM INSPECTION FEES

Petroleum inspection fees result from the fees imposed under s. 168.12(1), Wis. Stats., and payments received under ss. 101.143(4)(h)1m, 101.143(5)(a), and 101.143(5)(c), Wis. Stats. Under s. 168.12(1), Wis. Stats., a \$0.02 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 bonds.

The other petroleum inspection fees consist of penalty payments made under s. 101.143(4)(h)1m, Wis. Stats., by consultants for submitting claims for ineligible costs; proceeds under s. 101.143(5)(a), Wis. Stats., from the sale of remedial equipment and supplies that had originally been paid for by PECFA awards; and net recoveries under s. 101.143(5)(c), Wis. Stats., related to the Wisconsin Attorney General's actions against fraudulent claims. In FY 2010-11, these other petroleum inspection fees totaled \$2,698 and were made available to the trustee. In FY 2009-10, the other petroleum inspection fees totaled \$1,861 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, 2011, or June 30, 2010.

During FY 2010-11 and FY 2009-10, the following amounts of petroleum inspection fees were remitted by the Wisconsin Department of Revenue to the trustee, retained by the trustee to meet debt service requirements and pay Petroleum Inspection Fee Revenue Obligations Program administrative costs, and transferred by the trustee to the State of Wisconsin Petroleum Inspection Fund:

<u>Month</u>	Petroleum Inspection Fees Remitted by the State <u>to the Trustee</u>	Petroleum Inspection Fees Retained by the Trustee	Petroleum Inspection Fees Transferred by the Trustee <u>to the State</u>
July 2010	\$ 5,605,282	\$ 457,888	\$ 5,147,394
August	6,693,844	496,183	6,197,661
September	6,386,038	493,934	5,892,104
October	7,132,086	505,383	6,626,703
November	6,657,019	488,683	6,168,336
December	5,866,504	487,384	5,379,120
January 2011	4,228,103	498,923	3,729,180
February	8,348,595	484,284	7,864,311
March	5,527,209	484,383	5,042,826
April	6,739,032	497,383	6,241,649
May	4,967,631	486,383	4,481,248
June	<u>5,657,333</u>	<u>487,383</u>	<u>5,169,950</u>
Total FY 2010-11	<u>\$73,808,676</u>	<u>\$5,868,194</u>	<u>\$67,940,482</u>

<u>Month</u>	Petroleum Inspection Fees Remitted by the State <u>to the Trustee</u>	Petroleum Inspection Fees Retained by the Trustee	Petroleum Inspection Fees Transferred by the Trustee <u>to the State</u>
July 2009	\$ 6,166,941	\$ 2,299,898	\$ 3,867,043
August	7,457,544	2,211,133	5,246,411
September	5,234,794	2,212,351	3,022,443
October	6,267,373	518,100	5,749,273
November	6,246,988	495,259	5,751,729
December	6,166,412	487,759	5,678,653
January 2010	5,856,413	517,759	5,338,654
February	6,467,951	487,760	5,980,191
March	5,506,261	487,759	5,018,502
April	5,558,926	492,759	5,066,167
May	6,506,301	492,759	6,013,542
June	<u>5,104,589</u>	<u>492,760</u>	<u>4,611,829</u>
Total FY 2009-10	<u>\$72,540,493</u>	<u>\$11,196,056</u>	<u>\$61,344,437</u>

9. DEBT SERVICE COVERAGE RATIO FOR SENIOR DEBT

There are alternative methods to calculate debt service coverage. For purposes of additional analysis, the debt service coverage ratios for senior debt for FY 2010-11 and FY 2009-10 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 2010-11</u>	<u>Fiscal Year 2009-10</u>
Fees Remitted to the Trustee	\$73,808,676	\$72,540,493
Senior Debt Service:		
Principal—bonds	\$ 0	\$22,350,000
Interest—bonds	6,700,374	2,090,550
Interest—commercial paper	<u>285,115</u>	<u>541,856</u>
Total Senior Debt Service	\$6,985,489	\$24,982,406
Debt Service Coverage Ratio for Senior Debt	10.57	2.90

10. PECFA CLAIMS

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

The following table summarizes the activity related to PECFA claims during FY 2010-11 and FY 2009-10.

**Summary of PECFA Claims
July 1, 2009, through June 30, 2011
(in millions)**

	<u>FY 2010-11</u>	<u>FY 2009-10</u>
Approved but Unpaid PECFA Claims as of July 1	\$0.1	\$0.8
Claims Approved for Payment During the Fiscal Year	<u>8.9</u>	<u>8.8</u>
Total Approved PECFA Claims	9.0	9.6
Less Claims Paid:		
Paid from proceeds of revenue obligations and interest and investment income	0.0	0.0
Paid from petroleum inspection fees	<u>8.8</u>	<u>9.5</u>
Total Claims Paid During the Fiscal Year	<u>8.8</u>	<u>9.5</u>
Approved but Unpaid PECFA Claims as of June 30	\$0.2	\$0.1

In addition to the \$0.2 million in approved claims awaiting payment as of June 30, 2011, approximately \$1.2 million in claims submitted had yet to be both reviewed and approved. The Department of Safety and Professional Services estimates that additional claims for costs that landowners had incurred but had not submitted as of June 30, 2011, amount to approximately \$5.9 million. It also reports as of June 30, 2011, there were no claimants appealing determinations on previously finalized claims.

Report on Internal Control and Compliance ■

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters 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 Wisconsin Petroleum Inspection Fee Revenue Obligations Program for the years ended June 30, 2011, and June 30, 2010, and have issued our report thereon dated November 11, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits, we considered the program's internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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 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 will not be detected and corrected on a timely basis.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined in the preceding paragraph.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the program's Statement of Changes in Program Assets is free of material misstatement, we performed tests of the program's 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*.

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

November 11, 2011

LEGISLATIVE AUDIT BUREAU
by 
Bryan Naab
Deputy State Auditor for Financial Audit