

AN AUDIT

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July 1999

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State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

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July 30, 1999

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

Dear Senator George and Representative Kelso:

We have completed our financial and compliance audit of the State of Wisconsin, as requested by state agencies to meet the audit requirements of the federal Single Audit Act of 1984, as amended, and the provisions of federal Office of Management and Budget Circular A-133. Our audit covered the period July 1, 1997 through June 30, 1998. In addition to satisfying federal audit requirements, the audit assists us in meeting state audit requirements under s. 13.94, Wis. Stats.

The audit procedures performed at the larger state agencies that administer federal financial assistance programs, including the University of Wisconsin System, consisted of gaining an understanding of the internal controls at the agencies, assessing the propriety of revenue and expenditures, and testing compliance with laws and regulations related to the administration of federal grant programs. For the smaller agencies and selected University of Wisconsin campuses, our audit procedures were limited to verifying information included in the federally required Schedule of Expenditures of Federal Awards and following up on prior-year audit findings. Our review focused on the 28 federal grants that either exceeded the \$14.4 million threshold used by the federal government to define major grants or were below this threshold but were selected for review based on the risk-based assessment criteria established by the federal government.

The first section of our report contains the auditor's reports on internal control and compliance. Next are the agency narratives that contain our comments on internal control deficiencies related to the administration of federal grants, findings of noncompliance for each agency, and the results of our follow-up to prior audit findings. A summary schedule of findings and questioned costs for the current year's audit is also provided, as well as a summary of the status of findings included in our prior audit report for the State of Wisconsin (report 98-12). We note that, overall, state agencies have complied with federal grant requirements and that they have taken steps to address findings included in the prior year's single audit report. However, we do report internal control deficiencies and several areas of noncompliance, and we identify \$293,474 in questioned costs. This amount represents a small portion of the total federal financial assistance received by the State of Wisconsin.

Also included in this report is the Schedule of Expenditures of Federal Awards for the audited period, and related notes. Our audit opinion on the schedule is unqualified.

Senator Gary R. George and
Representative Carol Kelso
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The federal government will resolve the findings and questioned costs included in our report. Federal agencies are expected to contact state agencies regarding resolution. To assist federal officials in their efforts, state agency contact information is provided in appendices to this report.

In addition to the comments and recommendations included in our report, management letters will be issued to the larger state agencies addressing technical accounting issues, including those relating to the preparation of the State's financial statements.

We appreciate the courtesy and cooperation extended to us by agency staff during our audit. Agencies' comments on individual findings, along with their corrective action plans to address our concerns, are included within the agency narratives.

Respectfully submitted,

Janice Mueller
State Auditor

JM/BN/bh

SUMMARY

The State of Wisconsin administered \$5.4 billion in federal financial assistance during fiscal year (FY) 1997-98. As a condition of receiving federal assistance, the State is required to have an independent audit of its financial statements and of its compliance with federal grant program requirements. We performed this audit at the request of the various state agencies that received federal financial assistance and to meet our audit responsibilities under s. 13.94, Wis. Stats. To satisfy audit requirements, we gained an understanding of the internal controls, assessed the propriety of revenue and expenditures, and tested agency compliance with state and federal program requirements.

Our audit opinion on the State's general purpose financial statements was included in the Comprehensive Annual Financial Report for the fiscal year ended June 30, 1998. This report was issued by the Wisconsin Department of Administration in December 1998 and is available from the State Controller's Office.

The federal compliance portion of the single audit included audit work at the 22 state agencies that administered federal financial assistance programs. These agencies vary in size and complexity from the Department of Workforce Development (DWD), which administered nine major federal grant programs during FY 1997-98, to the Board on Aging and Long-Term Care, which administered only a few small grants and contracts.

Our audit did not include the federal grants administered by the Wisconsin Housing and Economic Development Authority and the Wisconsin Supreme Court. These entities are audited separately by other auditors.

As noted, the total amount of federal financial assistance administered by the State was \$5.4 billion in FY 1997-98. The Department of Health and Family Services (DHFS) administered \$2.0 billion, or 37 percent, of the State's cash and noncash federal financial assistance. The majority of these funds, \$1.7 billion, were disbursed for the Medical Assistance program. The State also contributed \$1.2 billion in general purpose revenue to fund this program.

The Department of Workforce Development also administers large federal programs. One of these programs is the Unemployment Insurance program, under which DWD expended almost \$520 million during FY 1997-98. In addition, DWD disbursed \$159 million in federal funds for the Temporary Assistance for Needy Families program and matched these expenditures with \$148 million of expenditures funded by the State's general purpose revenues.

The University of Wisconsin System (UW) expended \$672 million in federal aid during FY 1997-98. These expenditures included \$359 million for student financial aid, \$259 million under a variety of research and development grants, and \$54 million for other federal grants. Other state agencies administering significant federal programs include the Department of Transportation (DOT), which expended \$329 million in FY 1997-98 for the Highway Planning and Construction program; the Department of Public Instruction (DPI); the Department of Administration (DOA); and the Department of Natural Resources (DNR).

These seven large state agencies administered almost 97 percent of the federal financial assistance received by the State, and 26 of the State's 28 major grant programs. Accordingly, our audit effort concentrated on these state agencies.

We concluded that state agencies were in substantial compliance with federal grant program requirements. However, we noted instances of noncompliance with federal grant requirements and, in total, question \$293,474 in costs charged to various federal grant programs. These costs represent a small portion of the total federal financial assistance received during the year. In addition to findings that result in questioned costs, we identified instances of noncompliance that have no direct effect on the amount of federal financial assistance received or for which we could not readily determine the amount to question. Summaries of some of our more serious findings follow.

Department of Workforce Development

Federal rules and effective cash management require state agencies to minimize the period between the time they incur federal grant expenditures and the time they receive, or draw down, federal reimbursements. State agencies cannot, however, obtain federal funds in advance of incurring reimbursable expenditures. In addition, agencies should request reimbursement for only the federal government's share of expenditures for those grants that require the State to match federal expenditures with those funded from non-federal sources. During FY 1997-98, DWD initially received federal reimbursement for 100 percent of certain grant administrative expenditures, including those expenditures that should have been funded from non-federal sources. Although DWD transferred administrative expenditures to state accounts and returned previously received funds to the federal government during the next month, we estimate that the State earned over \$170,000 of interest at the expense of the federal government.

While the State should not receive federal reimbursement in advance of incurring grant expenditures, it should also ensure that it does not unnecessarily subsidize, even temporarily, the federal government, thereby causing lost interest to the State. Those state agencies that use the State's centralized cash management system to request federal reimbursements should reconcile their grant expenditure records to cash management system records to ensure reimbursements are received in a timely manner. However, DWD did not systematically perform this reconciliation and did not detect \$2.3 million of federal expenditures for which reimbursement was not received in a timely manner. As a result, state funds temporarily subsidized the federal government, resulting in an estimated \$77,000 of lost interest earnings to the State.

In addition to cash management concerns, we identified several other instances of noncompliance with federal requirements at DWD. For example, recipients of federal grant funds are allowed to charge expenditures directly to federal programs or to pools of costs, which are later allocated to federal and state programs. However, DWD assigned two expenditures totaling \$31,851 to an incorrect cost pool and, as a result, over-allocated costs to some federal grants while under-allocating costs to other grants. As a consequence, we question over \$8,000 charged to several different grant programs.

Department of Health and Family Services

As noted, some state agencies use the cash management system to receive federal reimbursement of grant expenditures, but it is also used to return funds previously received in the event of a reduction in grant expenditures. Agencies must code transactions accurately for them to be properly processed through the cash management system. We noted that DHFS did not completely code 20 transactions, which reduced grant expenditures by over \$255,000 and resulted in previously received funds not being returned to the federal government. During the course of our fieldwork, DHFS staff reviewed these transactions and returned the necessary funds to the federal government.

In addition, we noted several concerns regarding the administration of the Medical Assistance Program. First, DHFS has not established a security plan, conducted periodic risk analyses, or performed a biennial automated data processing system security review of the Medicaid Management Information System (MMIS), which is administered by a private contractor. Second, unlike other information used in the calculation of Medicaid claim payments, there is no retroactive adjustment processed by MMIS when updated information is received related to the patient's ability to pay for services. We noted one instance during FY 1997-98 of a claim overpayment that occurred because updated patient information was entered after the claim was paid. Because of the large number of claims processed during the year, additional overpayments are likely. Finally, we are concerned because DHFS did not reconcile expenditures reported to the federal government to federal reimbursements actually received and is not assured that all federal expenditures were reimbursed.

University of Wisconsin System

Although UW System was in substantial compliance with federal program requirements, we noted several instances of noncompliance with federal grant requirements and, in total, question \$10,058 of costs charged to federal programs. We identified three areas that are of particular concern because of their relative significance or because they represent a continuation of previously noted problems.

First, we identified unallowable expenditures that were charged against federal grants without being identified by UW-Madison's departmental or central processing staff. These inappropriate expenditures, which resulted in questioned costs of \$8,973, were caused by various staff miscommunications and oversights. According to UW-Madison,

these identified expenditures have been transferred from federal grant accounts to state accounts.

Second, at UW-Madison and UW-River Falls, we identified concerns related to student loan collection procedures, including the assignment of defaulted loans to the U.S. Department of Education and the use of collection agencies. These UW campuses were allowing defaulted loans to remain with collection agencies longer than federal regulations allow or longer than good loan management practices may dictate. In addition, we identified several loans that had been in default for significant periods of time, such as more than 10 years, without being assigned to the U.S. Department of Education.

Third, we again noted concerns with UW-Platteville's refund and overpayment policies and calculations, which could allow withdrawing students to receive funds in excess of their incurred costs. Overall, we question \$1,085, plus an undetermined amount, due to this problem.

Department of Administration

The Department of Administration charges state agencies for a variety of services, such as centralized mainframe computer processing services. State agencies, in turn, may seek federal reimbursement for the cost of those services incurred in administering federal grants. Occasionally excess funds, a portion of which may be attributable to the federal government, may accumulate in the DOA appropriations used to account for services provided to other state agencies. The Legislature directed DOA to lapse \$2 million during FY 1997-98 to the State's General Fund from the appropriation used to account for Information Technology Services. However, it appears likely that at least 20 percent, or \$400,000, of the amount lapsed is attributable to federal grant programs and, therefore, may need to be returned to the federal government. DOA informed the U.S. Department of Health and Human Services, which reviews internal service fees charged to federal grants, of this lapse and will need to work with that agency to determine any amounts that may be due the federal government.

Occasionally, state agencies or other entities receive income related to the administration of federal grants. Federal rules require that this income be used to offset the federal government's share of program expenditures or, if agreed to in advance, be used for other program purposes. We question \$49,200 in program income received by a nonprofit corporation with which DOA contracted to administer a grant program to assist low-income individuals in acquiring houses, because this income was from program fees that covered some of the same costs that DOA reimbursed the nonprofit corporation under the subgrant agreement.

Other State Agencies

We found noncompliance with various federal rules at other state agencies. For example, the Department of Natural Resources did not request federal reimbursements

in a timely manner. During FY 1997-98, DNR only requested federal reimbursement on a quarterly basis, or even less frequently. As of June 30, 1998, DNR had incurred unreimbursed expenditures totaling \$4 million for U.S. Environmental Protection Agency grants. We estimate that DNR's delays in requesting reimbursement under these grants resulted in the State losing more than \$68,000 of potential interest earnings.

Other noncompliance was found at the Department of Transportation, which did not credit the federal government for its share of a \$40,000 payment from a contractor as settlement for allegedly unlawful business practices. DOT agreed that federal rules were not followed and credited over \$21,000 to federal highway construction accounts in February 1999. In addition, the Higher Educational Aids Board did not adequately pursue collection from the federal government of at least \$4,761 of federally guaranteed student loans.

Each year we follow up on findings and recommendations included in our previous single audit reports. While most state agencies promptly implement corrective actions, sometimes a longer period is required to carry out the recommendations. This year we found that the Department of Public Instruction (DPI) and the Department of Agriculture, Trade and Consumer Protection (DATCP) had taken timely steps to address prior audit concerns. However, the Department of Military Affairs (DMA) and the Department of Commerce have only made partial progress in implementing prior audit recommendations. DMA failed to follow federal rules that require staff working solely on one federal grant to complete semi-annual certifications of their work effort. In addition, the Department of Commerce had not reviewed, as required by federal rules, 21 audit reports identified in our prior audit, and an additional 32 audit reports identified this year.

A summary of our federal findings and questioned costs can be found in Section III, pages 147 through 155, of the Schedule of Findings and Questioned Costs. The agencies' responses to the findings and their plans for corrective action are included within the body of the report. The federal government will contact state agencies to resolve the findings and questioned costs included in this report. A summary of the status of findings included in our prior audit report (report 98-12) is presented on pages 157 through 170.

Issues addressing technical accounting matters, including those related to the preparation of the State's financial statements, are included in management letters and other audit communications for various state agencies. Summaries of the more serious concerns related to financial reporting are included in Section II of the Schedule of Findings and Questioned Costs.

INTRODUCTION

The State of Wisconsin administered \$5.401 billion of federal financial assistance during fiscal year (FY) 1997-98. Of that total, \$4.674 billion consisted of cash disbursements; the remaining \$727 million consisted of noncash items such as food stamps, food commodities, and outstanding loans. As a condition of receiving federal funds, the State must meet the audit requirements of the federal Single Audit Act of 1984, as amended, and federal Office of Management and Budget (OMB) Circular A-133, unless specifically exempted by the federal government. The audit report must contain the auditor's report on the general purpose financial statements; the auditor's report on the State's compliance and internal control over financial reporting; and the auditor's report on the State's compliance with requirements applicable to each major program, internal control over compliance in accordance with OMB Circular A-133, and schedule of expenditures of federal awards. We also incorporated into the report narrative the agencies' responses to our findings and their corrective action plans. The report, along with other required information, is submitted to the federal government to fulfill the State's single audit report distribution requirements of OMB Circular A-133.

The statewide annual financial and compliance audit covers the period July 1, 1997 through June 30, 1998. Federal rules allow the auditor to use judgment to select those grants that may contain a higher risk of noncompliance with federal regulations. For the State of Wisconsin, OMB Circular A-133 categorizes as "type A" grants those grants for which the State expended \$14.4 million or more of federal funds. We reviewed and tested those type A grants that we believe are subject to higher risk of noncompliance. Federal rules allow the auditor to test other type A grants only once every three years, rather than each year. Accordingly, we selected about one-third of the lower-risk type A grants to audit this year. For each type A grant not audited during the current audit, federal rules require the auditor to select another grant for audit, referred to as a "type B" grant, with expenditures under the \$14.4 million threshold. The purpose of selecting additional grants is to ensure a variety of grants, rather than just the largest grants, are audited each year while still ensuring that the largest grants are audited at least once every three years.

As required by OMB Circular A-133, we tested compliance with laws and regulations related to federal grant programs, contracts, and subgrants the State administered. Our compliance review focused on the 17 type A grants and 11 type B grants listed in Note 2 to the Schedule of Expenditures of Federal Awards. These grants were administered by 15 different state agencies and campuses and accounted for 69 percent of the federal financial assistance administered by the State. We also followed up on findings included in our prior audit report for the State of Wisconsin (report 98-12).

In addition to satisfying federal audit requirements, the audit work performed at state agencies assists in meeting state audit requirements identified in s. 13.94, Wis. Stats. The scope of the single audit did not include the federal awards administered by the Wisconsin Housing and Economic Development Authority and the Wisconsin Supreme Court. These entities are audited separately by other auditors.
