

**Report 19-26  
December 2019**

# **State-Owned Residential Properties**

STATE OF WISCONSIN



Legislative Audit Bureau ■



# **State-Owned Residential Properties**

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# STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman  
State Auditor

December 6, 2019

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

Dear Senator Cowles and Representative Kerkman:

In response to a report to our Fraud, Waste, and Mismanagement Hotline, we initiated an audit of certain state-owned residential properties managed by state agencies and leased to state employees. Statutes require the Department of Administration (DOA) to administer those properties by developing policies, conducting appraisals, and determining rental payment amounts to ensure rental payments state agencies charge state employees are based on the fair value of the properties.

As of December 2018, the Department of Natural Resources (DNR) managed 32 state-owned residential properties occupied by 32 employees, and the University of Wisconsin (UW) System managed a total of 114 properties occupied by 171 employees. UW institutions required employees to reside in 15 of the properties in December 2018, whereas other UW employees opted to reside in the properties.

We found DOA has not formally revised policies since 1975 and, although DOA has been statutorily required to conduct appraisals of state-owned residential properties every 10 years since 1991, DOA has not conducted appraisals since 1995. Although DOA calculated rental payment adjustments that averaged 2.3 percent annually between 1998 and 2018, DNR and UW System did not implement all rental payment adjustments. We also found DNR demonstrated compliance with Internal Revenue Service guidelines in only 2 of the 32 lease agreements in effect in December 2018, and UW institutions demonstrated compliance in only 3 of 16 lease agreements.

We recommend DOA comply with statutory requirements, reassess practices surrounding state-owned residential properties, and increase its monitoring and oversight of these properties. We also recommend DNR and UW System comply with DOA policies and improve the management of lease agreements each executes with state employees.

We appreciate the courtesy and cooperation extended to us by DOA, DNR, and UW System. A response from each agency follows the appendices.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Joe Chrisman'.

Joe Chrisman  
State Auditor

JC/SH/ss





## Introduction ■

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***Some employees may be required to reside in state-owned properties as a condition of employment, while other employees may opt to reside in them.***

In response to a report to our Fraud, Waste, and Mismanagement Hotline, we initiated an audit of certain state-owned residential properties currently managed by state agencies and leased to state employees. Certain employees may be required to reside in the properties as a condition of employment and may receive a discount on rental payments. In other instances, employees may opt to reside in them.

Under provisions of ch. 16, Wis. Stats., the Department of Administration (DOA) is required to administer state-owned residential properties that are managed by state agencies. These requirements, which were originally established during the 1975 legislative session, were revised through 1991. Policies DOA developed in 1975 emphasized eliminating or reducing the number of state-owned residential properties in which state employees opt to reside.

According to DOA records, there were 92 state-owned residential properties in 1996 managed by six state agencies, including the:

- Department of Corrections;
- Department of Health Services;
- Department of Military Affairs;
- Department of Natural Resources (DNR);

- Department of Veterans Affairs; and
- University of Wisconsin (UW) System.

Over time, many state-owned residential properties were either razed, sold, or the agencies found other uses for the facilities. However, we found that only DNR and certain UW System institutions continued to manage the properties that were occupied by state employees. As a result, we limited our audit to DNR and UW System.

### DNR Residential Properties

***As of December 2018, 32 state-owned residential properties were occupied by DNR employees.***

According to available records, DNR managed 55 state-owned residential properties available to lease to state employees as of December 2018. We found that 32 of the 55 properties were occupied by DNR employees as a primary residence and the remaining 23 properties were vacant as of December 2018. As shown in Table 1, the 32 occupied properties were located largely in state parks, fish hatcheries, and state forests.

Table 1

**State-Owned Residential Properties Managed by DNR<sup>1</sup>**  
As of December 2018

Property Type	Number of Properties
State Park	14
Fish Hatchery	8
State Forest <sup>2</sup>	5
Other	5
<b>Total</b>	<b>32</b>

<sup>1</sup> Includes properties occupied by DNR employees as a primary residence.

<sup>2</sup> Includes properties managed by DNR’s Fish, Wildlife, and Parks Division. In December 2018, no occupied properties were within DNR’s northern state forests, which are managed by the Forestry Division.

DNR also managed state-owned residential properties that are occupied by employees on a temporary, month-to-month basis but not as primary residences. The majority of these properties are dormitory or family-style residential options for limited-term

employees in positions DNR identified as primarily being active only during the summer season. According to DNR records, 36 employees were in month-to-month lease agreements as of July 2019. Because of the seasonal and temporary nature of these arrangements, these properties were not included in the scope of this audit.

## UW System Residential Properties

***As of December 2018, UW System managed 114 state-owned residential properties that were occupied by UW employees.***

According to available records, UW System managed 114 state-owned residential properties that were occupied by UW employees as of December 2018. As shown in Table 2, the largest number of properties were apartment buildings in which employees may opt to reside. UW-Madison had 96 apartment buildings in which faculty and academic staff resided. UW System Administration, UW-Platteville, UW-River Falls, and UW-Stevens Point also managed properties in which employees resided as a primary residence.

Table 2

### State-Owned Residential Properties Managed by UW System<sup>1</sup> As of December 2018

Property Type	UW-Madison	Other UW Institutions	Total
Apartment Buildings	96	2	98
Research Stations	12	4	16
<b>Total</b>	<b>108</b>	<b>6</b>	<b>114</b>

<sup>1</sup> Includes properties occupied by employees in Wisconsin Retirement System–eligible positions as a primary residence. Excludes properties that predominately housed students, state-owned chancellor residences at five UW institutions, and the UW System President’s residence.

In addition to these properties, the State owns chancellor residences at five UW institutions, the UW System President’s residence, and properties to house students, including undergraduate student residential halls and other housing options for graduate students, some of whom also are employed by UW institutions. These properties were not included in the scope of this audit.

## IRS Guidelines Applicable to Employer-Provided Housing

***IRS guidelines specify the criteria that must be met to avoid treating housing provided by the employer or rental payment discounts as taxable income for an employee.***

Internal Revenue Service (IRS) guidelines prohibit employers from providing housing or discounts on rental payments as a means to increase employee wages without increasing the employee's taxable income. Therefore, IRS guidelines specify that all of the following criteria must be met to avoid treating housing provided by the employer or rental payment discounts as taxable income for an employee, including:

- the residence is located on the employer's business premises;
- the employee resides in the property for the convenience of the employer; and
- the employee is required to reside in the property as a condition of employment because residing within the employer's property is necessary for the employee to properly conduct job responsibilities, and the terms are agreed to at the beginning of employment.

State employees who reside in state-owned properties and meet these conditions are not taxed on any discounted rental payment amount. Conversely, state employees who opt to reside in the properties are required to report as taxable income any difference between their actual rental payment and the fair value of rent, as determined through an appraisal, when the actual rental payment is lower than the fair value. Although IRS guidelines include some additional exceptions applicable to employees of educational institutions who opt to reside in state-owned properties, these exceptions are permitted when rental payments are based on annual appraisals of the property.

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# Requirements and Policies for Residential Properties ■

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Wisconsin Statutes require DOA to administer state-owned residential properties. However, we found DOA did not comply with all statutory requirements. Although DOA is statutorily required to conduct an appraisal of these properties every 10 years, it has not conducted any appraisals since 1995. DOA also has not actively provided monitoring or oversight of state agency compliance with its existing policies for these properties. For example, DOA did not track properties occupied by state employees, retain copies of active lease agreements, or assess whether agencies implemented required rental payment adjustments. We recommend that DOA comply with statutory requirements and take steps to actively monitor and oversee state-owned residential properties.

## Statutory Requirements

Under s. 16.004 (8), Wis. Stats., DOA is required to:

- maintain a system of rental policies for state-owned residential properties, periodically review these policies, and submit any proposed changes to these policies to the Joint Committee on Finance;
- conduct appraisals of the fair value of state-owned residential properties following each federal decennial census;

- establish periodic rental payment adjustments if no appraisal was conducted in the previous 24 months; and
- develop a procedure for reviewing the need to retain state-owned residential properties and submit recommendations for disposing of properties to the State of Wisconsin Building Commission.

***DOA has not formally revised its policies for state-owned residential properties since 1975.***

We found DOA has not formally revised its policies for state-owned residential properties since 1975. These policies addressed establishing and updating rental payment amounts and specified provisions state agencies should include in executing lease agreements with state employees, such as establishing the responsibility for payment of utility costs and performing maintenance of the properties.

### **Residential Property Appraisals**

***DOA did not comply with statutes because it did not conduct appraisals of state-owned residential properties following either the 2000 census or the 2010 census.***

Under s. 16.004 (8) (e) 2., Wis. Stats., DOA is required to conduct appraisals of state-owned residential properties following each federal census. After this provision was enacted in 1991, DOA conducted appraisals of the properties in 1995. However, DOA did not conduct appraisals following either the 2000 census or the 2010 census. Because rental payment amounts are determined from appraisals, DOA cannot be assured the rental payment amounts reflect the current fair value of the properties. DOA staff indicated that several reorganizations among its divisions subsequent to 2002 resulted in the responsibilities for administering the properties not being reassigned to any specific division.

### **Determining Rental Payment Amounts**

State employee rental payment amounts are determined using three factors. First, as required by statutes, a base rental amount is determined through an appraisal. Second, statutes require DOA to determine periodic rental payment adjustments between appraisals. Third, under DOA policies, certain discounts may be applied to the rental payment amount.

***Between 1998 and 2018, DOA established rental payment adjustments that increased rental payment amounts an average of 2.3 percent annually.***

We found that DOA established base rental payment amounts using the 1995 appraised value for each state-owned residential property. Because no appraisals were conducted after 1995, DOA biennially determined rental payment adjustments between 1998 through 2018 that were implemented as incremental, annual increases during each biennium. These rental payment adjustments, which were based on the Consumer Price Index, increased rental payment amounts an average of 2.3 percent annually.

DOA communicated these adjustments to state agencies, including UW System. The state agencies were then responsible for communicating the required rental payment adjustments to their employees as necessary and implementing new rental payment amounts based on these adjustments. However, DOA did not monitor whether state agencies implemented the rental payment adjustments in lease agreements the agencies executed with state employees.

***DOA policies allow state agencies to provide a 50.0 percent rental payment discount to employees who meet the requirements of IRS guidelines.***

DOA policies permit state agencies to provide rental payment discounts in certain circumstances. For example, state agencies may provide an employee a 50.0 percent rental payment discount if the employee meets IRS guidelines for excluding the discount from the employee’s taxable income, including that the agency required that the employee reside in a state-owned property as a condition of employment. Each state agency determines whether residing in the property is a requirement of an employee’s position. In addition, DOA policies require that monthly rental payment amounts cannot exceed 12.0 percent of the employee’s monthly wages. Finally, if an employee opts to reside in the property, agencies may provide a 10.0 percent rental payment discount.

## **Improving Administration of Residential Properties**

***DOA did not track all state-owned residential properties for which it is statutorily responsible and did not monitor state agency compliance with its policies.***

Although DOA is statutorily required to administer state-owned residential properties, it did not perform overall monitoring to ensure agencies complied with DOA policies. For example, DOA did not track all properties subject to its oversight. If DOA had done so, it may have identified that state agencies were not following its policies.

Although DOA’s communications on biennial rental payment adjustments requested that state agencies provide it with the adjusted rental payment amounts, DOA did not attempt to obtain this information when agencies failed to comply with its requests. DOA should ensure that state agencies provide confirmation that the adjustments are implemented. If DOA had done so, it would have been able to identify how many properties were occupied and

determine instances in which state agencies did not charge an appropriate rental payment.

DOA should work with agencies to reassess whether to retain state-owned residential properties, including recommending to the State of Wisconsin Building Commission whether any of the properties should be sold, razed, or used for other purposes. Although a state agency is typically responsible for determining whether to retain a property, these decisions do not appear to have involved DOA in recent years.

**Conducting regular appraisals helps to ensure that rental payment amounts reflect fair value of state-owned residential properties.**

Statutes require that the cost of appraisals should be funded from the appropriations in which rental payment receipts are deposited. Conducting regular appraisals helps to ensure that rental payment amounts reflect fair value of state-owned residential properties. Although the cost of conducting appraisals may outweigh the potential increased rental payment amounts state agencies receive from employees who reside in the properties, appraisals will assist DOA in identifying whether biennial rental payment adjustments are effective in approximating fair value.

**Recommendation**

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*We recommend the Department of Administration take steps to improve its administration of state-owned residential properties, including by:*

- *complying with statutes by periodically reviewing and formally revising applicable policies;*
- *tracking state-owned residential properties subject to its oversight and monitoring the rental payment amounts state agencies charge employees;*
- *complying with statutes by conducting appraisals of all state-owned residential properties;*
- *complying with statutes by working with state agencies to assess whether residential properties should be retained and making recommendations to the State of Wisconsin Building Commission; and*
- *reporting to the Joint Legislative Audit Committee by April 10, 2020, on the status of its efforts to implement these recommendations.*



## **Issue for Legislative Consideration**

As noted, DOA must provide to the Joint Committee on Finance any proposed changes to its policies for state-owned residential properties. To further increase its oversight of DOA's administration of state-owned residential properties, the Legislature may wish to consider creating a statutory requirement for DOA to report biennially a list of the properties and the current rental payment amount for each property.

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# Department of Natural Resources Residential Properties ■

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The state-owned residential properties managed by DNR were largely obtained as part of land acquisitions and retained for residential use. In executing lease agreements, we found DNR incorrectly calculated rental payment amounts for its properties. We also found that not all of the rental payment discounts DNR provided to state employees in executed lease agreements complied with DOA policies and IRS guidelines. We recommend that DNR comply with DOA policies, better track the properties it manages, and improve communication among DNR staff involved in these processes. We also recommend DNR reassess whether employees should be required to reside in the properties.

## Current Uses of Residential Properties

***Properties managed by DNR were primarily located within state parks, fish hatcheries, and state forests.***

As noted, DNR managed 55 state-owned residential properties available to lease to state employees as of December 2018. We found that 32 of the 55 properties were occupied by DNR employees as a primary residence, and the remaining 23 properties were vacant. These properties were primarily located within state parks, fish hatcheries, and state forests and were largely occupied by DNR park rangers, fishery technicians, property supervisors, and facilities repair workers. A list of the locations of the 32 properties leased to DNR employees as of December 2018 is Appendix 1.

***DNR indicated that the State benefits from employees occupying state-owned residential properties.***

According to DNR staff, the state-owned residential properties occupied by state employees benefit the State because they attract potential employees, provide housing in rural areas where alternative housing options may be limited, and allow employees to remain on-site outside of normal working hours. DNR described most of these properties as modest single-family homes that are generally located in rural areas. For example, one residential property located in a state park is a ranch-style, 1,700 square-foot home that had an assessed value of \$106,000 in 2009. Properties are maintained in good condition, but DNR indicated that some of them are up to 100 years old. Although we did not review the complete leasing history for each property, we found 17 of the 32 DNR employees in a lease agreement during December 2018 had lived in a state-owned residential property since at least 2016, including one employee who had resided in a property since 1993.

### **Employee Lease Agreements**

Based on statutory requirements, DOA policies, and practices for effective management of state-owned residential properties, we expected DNR would have:

- implemented policies and procedures sufficient to ensure compliance with DOA policies;
- executed written lease agreements outlining significant terms, including payment of utilities, and retained the agreements for the duration of the period in which the employee resided in the property;
- followed DOA policies in determining rental payment amounts and adjusted rental payment amounts in a timely manner as required by DOA, including communicating rental payment amounts in writing to the employee and administrative staff as necessary;
- collected all rental payment amounts; and
- demonstrated compliance with DOA policies and IRS guidelines when providing rental payment discounts, including by documenting a requirement to reside in a state-owned property as a condition of employment and ensuring this residency was necessary for the employee to properly conduct job responsibilities.

## Administrative Policies and Procedures

***DNR lacked detailed procedures, including who was responsible for administrative responsibilities or how it communicated its policies to all necessary staff.***

We found DNR had a policy for employees residing in state-owned properties that was similar to provisions of DOA policies, including specifying when a 50.0 percent discount may be applied to rental payment amounts. The DNR policy also referenced IRS guidelines, including that the employee be required to reside in the property as a condition of employment. However, DNR lacked detailed procedures about how the policy should be administered, who was responsible for these procedures, how it communicated its policy to all necessary staff, or how it monitored for continual compliance with both its policy and DOA's policies.

## Executing Lease Agreements

***DNR executed lease agreements in September 2018 for all 32 DNR properties that were occupied in December 2018.***

We requested lease agreements between DNR and state employees and found that lease agreements had been signed in September 2018 for each of the 32 DNR properties that were occupied in December 2018. We found one DNR employee signed all lease agreements and the terms of these lease agreements complied with existing DOA policies, including requiring the employee to pay for utilities and conduct routine maintenance of the property.

## Determining Rental Payment Amounts

We reviewed DNR's determination of rental payment amounts for its lease agreements in effect with state employees as of December 2018. We considered whether DNR consistently and accurately considered the base rental amount determined through a DOA appraisal, adjusted the rental payment amounts biennially as required by DOA, and correctly applied discounts, if applicable.

***In the absence of periodic appraisals by DOA, DNR reassessed the fair value of some properties as they were vacated and established a new base rental payment amount.***

For the majority of the state-owned residential properties, it appears DNR continued to use the base rental payment amounts DOA established through its 1995 appraisals. However, in the absence of periodic appraisals by DOA, DNR reassessed the fair value of some properties as they were vacated and before a new lease agreement was executed with another state employee. DNR then established a new base rental payment amount, applied a 50.0 percent discount, and continued to apply biennial rental payment adjustments as determined and communicated by DOA.

***No DOA appraisals were conducted for 13 properties DNR acquired since DOA last conducted appraisals in 1995.***

According to DNR records, it managed 13 state-owned residential properties that were not appraised by DOA because DNR acquired them after the 1995 appraisals were conducted. In December 2018, five of the properties were occupied and eight were vacant. According to DNR staff, the properties were largely acquired through land bequests or land acquisitions in which a residential property was located. Because no appraisals had been conducted by DOA since 1995, DNR had taken steps similar to those previously described to assess the fair value of the properties.

***DNR will have undercharged an estimated \$38,900 for rental payments during 2019.***

Although DOA consistently determined rental payment adjustments, we found DNR did not implement 10 of 21 adjustments established by DOA between 1998 and 2018. We cannot determine from available information what the rental payment amounts would have been had DOA completed an appraisal in recent years. However, DNR was required to accurately implement all rental payment adjustments determined by DOA. We found DNR did not charge employees the full rental payment amounts because it did not accurately implement all adjustments. Based on rental payment amounts charged in December 2018, DNR will have undercharged an estimated \$38,900 for rental payments during 2019.

***DNR did not implement 3 of the 11 rental payment adjustments until more than one year after the required effective date.***

We also found 6 of the 11 rental payment adjustments implemented by DNR since 1998 were not implemented in a timely manner, including 3 adjustments that were not implemented until more than one year after the required effective date. For example, in May 2016 DOA communicated a 1.74 percent adjustment to rental payment amounts effective in August 2016 and July 2017. However, DNR did not enter into new lease agreements reflecting these adjustments until September 2018. Although DNR eventually made corrections to employee rental payment amounts when it identified the omission, the amounts that employees paid between 2016 and 2018 were less than they should have paid. We also found rental payments for one DNR employee had been unchanged since at least 2010. DNR was unable to explain why this employee's rental payment had not been adjusted.

### **Collecting Rental Payments**

***From 2016 through 2018, DNR collected approximately \$110,000 annually in rental payments from state employees.***

DNR employees who reside in state-owned properties as primary residences make rental payments through biweekly payroll deductions. In December 2018, payroll rental deductions for the 32 DNR employees totaled \$10,070, with an average monthly rental payment of \$347. From 2016 through 2018, DNR collected approximately \$110,000 annually in rental payments from state employees.

From 2016 through 2018, DNR did not collect approximately \$1,000 in rental payments that we expected should have been collected. We found other instances in which DNR failed to update the payroll system to terminate a rent deduction in a timely manner after an employee vacated a state-owned residential property. In 22 instances, totaling \$6,600, an employee received a refund related to rent. We also found that the majority of these refunds were processed by DNR to adjust for rental deductions that inadvertently continued after the employee no longer resided in the property or to correct for an overpayment by the employee as a result of timing differences between the termination of the employee's lease agreement and the biweekly payroll. We also found that, from September 2018 through June 2019, DNR collected the stated amount of rental payments included in lease agreements it executed in September 2018.

### **Demonstrating Compliance with IRS Guidelines**

***DNR demonstrated compliance with IRS guidelines in only 2 of 32 lease agreements in effect in December 2018.***

We found all of the 32 lease agreements in effect in December 2018 included a 50.0 percent rental payment discount. In order to not treat the discount amount as taxable income for the employee, DNR was required to comply with IRS guidelines. Therefore, DNR should have documented in appointment letters that the employee was both required to reside in a state-owned property as a condition of employment and that residing in the property was necessary for the employee to properly conduct job responsibilities. However, we found that DNR demonstrated compliance with IRS guidelines in only 2 of the 32 lease agreements. An additional 5 lease agreements met one, but not both, of the requirements, and 25 lease agreements met neither requirement. During our audit, DNR reassessed the 32 lease agreements and confirmed that most employees who occupied its state-owned residential properties had opted to do so.

For three of the five lease agreements that met one but not both requirements, DNR appointment letters stated the employee was required to reside in a state-owned property as a condition of employment, but the employee did not need to reside in the property to properly conduct job responsibilities. For example, a 2013 appointment letter stated that a state park property supervisor was required to reside in the property. However, although the State may have benefited from the employee residing on-site, the employee's job responsibilities did not require residence in close proximity of the state park. Further, DNR staff indicated that if it conducted a recruitment for this employee's position in the future, it would consider candidates that did not agree to reside in the property.

For two of the five lease agreements that met one, but not both requirements, DNR did identify a need for the employee to reside

in the state-owned property to conduct job responsibilities. However, DNR did not consistently state the requirement in its appointment letters. For example, DNR justified the need for four fish hatchery employees to reside in the properties in order for them to monitor fish propagation operations and to respond quickly to conditions that could adversely affect production. However, only two of the four appointment letters stated that residing in the property was a condition of employment.

If DNR did not meet both requirements, the employee should not have received a 50.0 percent rental payment discount under DOA and DNR policies. Further, IRS guidelines require that the State determine whether the 50.0 percent discount was appropriately considered when preparing annual tax information for employees, such as in instances in which discounts may have been taxable income.

***The 50.0 percent rental payment discount was not included as taxable income within 2018 tax information the State prepared for any of the 32 DNR employees.***

We found that the 50.0 percent rental payment discount was not included as taxable income within 2018 tax information the state prepared for any of the 32 DNR employees who resided in state-owned properties in December 2018. Because DNR considered all employee lease agreements as having met both requirements of IRS guidelines, it is unlikely that DNR would have considered the 50.0 percent rental payment discount as taxable income.

We did not review DNR's complete leasing history for each property. However, based on our findings, DNR should not have provided a 50.0 percent discount to all employees and, therefore, should consider tax implications for these employees.

## **Improving Management of Residential Properties**

Although DNR had lease agreements readily available for all 32 employees residing in a state-owned property in December 2018, and generally collected the majority of rental payments in a timely manner by using payroll deductions, it did not fully comply with requirements and expectations for management of state-owned residential properties.

***DNR lacked timely and accurate communication among those who worked directly with employees residing in state-owned properties and employees who executed lease agreements.***

We found DNR's method of tracking state-owned residential properties it managed did not provide sufficient information to ensure that all property information was accurate or that rental payment amounts were accurately determined. There was also insufficient communication or understanding among DNR staff who maintained properties and hired employees to reside in them and those DNR staff who executed lease agreements and determined rental payment amounts. For example, errors in determining rental payment amounts



in some instances resulted from not communicating changes or adjusting payroll rent deductions in a timely manner.

We also found DNR incorrectly executed lease agreements as if all employees were required to reside in the state-owned residential properties as a condition of employment since 1995. However, the need for employees to reside in the properties changed over time. For example, the DNR staff member currently responsible for an employee hired in 2010 and for the property in which this employee resided was not aware that the employee's appointment letter stated the employee was required to reside in the property. This staff member did not consider the employee as one who is required to reside on-site to properly conduct job responsibilities. This staff member indicated to us that if the current employee terminated employment, the residence would be offered to another employee who could opt to reside in the property.

Finally, we found DNR did not develop comprehensive written procedures for managing state-owned residential properties. Had DNR done so, it may have more accurately and consistently applied all DOA policies in lease agreements it executed with state employees who resided in state-owned properties. When DOA revises its policies, DNR should be proactive in ensuring changes to DNR's written procedures are implemented accurately and in a timely manner.

DNR should comply with DOA policies in executing lease agreements with state employees. To improve its management of state-owned residential properties, DNR should also implement all required rental payment adjustments in a timely manner; better track its properties; improve communication among DNR staff; collect all rental payment amounts; execute new lease agreements for those in which it incorrectly provided rental payment discounts; consider tax implications for current and prior lease agreements that did not comply with DOA policies; reassess whether it is necessary for employees to reside in properties it manages; and create comprehensive written procedures that align with DOA policies.

#### **☑ Recommendation**

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*We recommend that the Department of Natural Resources take steps to improve its management of state-owned residential properties, including by:*

- *complying with Department of Administration policies in executing lease agreements with employees residing in state-owned residential properties;*

- *accurately implementing all rental payment adjustments required by the Department of Administration in a timely manner;*
- *developing a formal mechanism to track information for its state-owned residential properties;*
- *improving communication among staff when employees terminate employment or discontinue residing in a state-owned property in a timely manner to ensure the rental payment does not continue to be charged;*
- *proactively monitoring uncollected rental payments and following up in a timely manner with employees to receive these payments;*
- *executing new lease agreements to correct rental payment amounts that incorrectly included a 50.0 percent rental payment discount;*
- *considering the tax implications of rental payment discounts it incorrectly provided in current and prior lease agreements;*
- *reassessing its residential properties to determine whether it is necessary for an employee to reside in the property to properly conduct job responsibilities;*
- *formally documenting its procedures for managing state-owned residential properties and communicating them to all appropriate staff; and*
- *reporting by April 10, 2020, to the Joint Legislative Audit Committee on the status of its efforts to implement these recommendations.*

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# University of Wisconsin System Residential Properties ■

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UW System’s state-owned residential properties include apartment buildings and research stations. In executing lease agreements, we found UW institutions did not set rental payment amounts in ways that complied with DOA policies and UW-Madison did not have lease agreements for all employees who resided in a state-owned property. We also found not all rental payment discounts UW institutions provided to employees complied with DOA policies and IRS guidelines. We recommend that UW System Administration establish system-wide policies to improve accuracy and consistency in executing lease agreements with employees, comply with DOA policies in determining rental payment amounts, and improve documentation when requiring employees to reside in such properties. We further recommend that UW System Administration work with DOA to develop policies that specifically address lease agreements for employees who opt to reside in state-owned apartment buildings.

## **Current Uses of Residential Properties**

***UW System had 15 state-owned properties in which it required employees to reside as of December 2018.***

As shown in Table 3, UW System’s residential properties include apartments and research stations, which are largely agricultural in nature. UW institutions required employees to reside in 15 of the 114 state-owned properties as of December 2018. A list of the locations of the 15 properties leased to UW employees as of December 2018 is Appendix 2.

Table 3

**UW System State-Owned Residential Properties<sup>1</sup>**  
As of December 31, 2018

Property Type	UW Institution	Employee Required to Reside	Employee Opted to Reside
<b>Apartment Buildings</b>			
	Madison	–	96
	System	1	1
	Subtotal	1	97
<b>Research Stations</b>			
	Madison	12	–
	Platteville	1	–
	River Falls	–	2
	Stevens Point	1	–
	Subtotal	14	2
<b>Total</b>		<b>15</b>	<b>99</b>

<sup>1</sup> Includes those properties occupied by employees in Wisconsin Retirement System–eligible positions and who resided in the properties as a primary residence. Excludes the properties designed for chancellors and the UW System President and those that predominately housed students.

According to UW System Administration, the state-owned residential properties occupied by UW employees benefit the State because they serve to attract potential employees, provide housing close to campuses, or allow employees to remain on-site outside of normal working hours to complete job responsibilities. According to UW-Madison staff, apartments are comparable to others within the surrounding area and the homes located at research stations, though well maintained, are up to 100 years old.

UW-Madison manages most of the apartments, which are largely provided to employees who opt to reside in them. A total of four UW institutions maintain research stations that included 16 state-owned residential properties, including UW-Madison, UW-Platteville, UW-River Falls, and UW-Stevens Point. Although UW-River Falls did not require employees to reside at a research station, UW-Madison, UW-Platteville, and UW-Stevens Point did so to manage the farms and wildlife areas located within the stations. Finally, two residential properties were located on the UW System President’s residence grounds, including one in which UW System Administration required an employee to reside and one in which no employee was required to reside.

***As of December 2018, 171 UW System employees resided in a state-owned property, of which UW institutions required 16 employees to reside in the properties.***

As shown in Table 4, we identified 171 UW System employees who resided in a state-owned property as of December 2018. We found 124 of the 171 employees were academic staff who were not required to reside in the apartment buildings. The number of employees exceeds the number of properties because buildings had multiple apartment units and several employees may reside within an apartment. In total, there were 16 employees required to reside in 15 properties as of December 2018 because two employees resided within one of the properties.

Table 4

**UW Employees Residing in State-Owned Properties**

As of December 31, 2018

Employment Category	Employee Required to Reside	Employee Opted to Reside	Total
Academic Staff	11	124	135
Faculty	1	19	20
Administrative Staff	4	12	16
<b>Total</b>	<b>16</b>	<b>155</b>	<b>171</b>

**Employee Lease Agreements**

Based on statutory requirements, DOA policies, and practices for effective management of state-owned residential properties, we expected UW System would have:

- implemented policies and procedures sufficient to comply with DOA policies;
- executed written lease agreements outlining significant terms, including payment of utilities, and retained the agreements for the duration of the period in which the employee resided in the property;
- followed DOA policies in determining rental payment amounts and adjusted rental payment amounts in a timely manner as required by DOA, including communicating rental payment amounts in writing to the employee and administrative staff as necessary;

- collected all rental payment amounts; and
- demonstrated compliance with DOA policies and IRS guidelines when providing rental payment discounts, including by documenting a requirement to reside in a state-owned property as a condition of employment and ensuring this residency was necessary for the employee to properly conduct job responsibilities.

***As of December 2018, 12 of the 15 state-owned residential properties were occupied by UW-Madison employees who were required to do so.***

We focused our audit on the 16 employees that UW institutions required to reside in 15 state-owned properties. We found that 12 of these properties were occupied as of December 2018 by UW-Madison employees.

**Administrative Policies and Procedures**

We found that staff in UW System Administration were aware of DOA’s policies and had some central information on state-owned residential properties managed by UW institutions, but all management of lease agreements with employees occurred at the institution level. No system-wide policies existed for managing the properties or executing lease agreements with employees who resided in them.

**Executing Lease Agreements**

We requested lease agreements for all 16 UW employees required to reside in a state-owned property in December 2018. Based on available documents, we found that some employees had been residing within state-owned residential properties for many years, including one employee who had been residing at a research station since 1998.

***For 6 of 12 employees it required to reside in properties located at agriculture research stations, UW-Madison was unable to provide lease agreements in effect in December 2018.***

UW-Madison provided signed lease agreements for 6 of 12 employees residing at agriculture research stations. However, it was unable to provide the remaining 6 lease agreements in effect in December 2018, and indicated that each of these leases was signed when the employee was originally hired and could not be located. In response to our request, UW-Madison executed new lease agreements in four instances. Because lease agreements help minimize the legal liability of a lessor by clearly defining the responsibilities of both parties and indicating the process for amending or terminating the agreement, it is important that all UW institutions execute and maintain lease agreements with employees residing in state-owned properties.

***UW-Madison should formally communicate a rental payment amount in writing.***

For those lease agreements we obtained from UW-Madison, we also found that rental payment amounts were not included in the lease agreements or recorded in any other documents. Instead, it appears rental payment amounts were verbally communicated to the employees. Although new leases are not executed each year, UW-Madison should formally communicate a rental payment amount in writing, including documenting when that amount was revised and communicated to the employee.

### **Determining Rental Payment Amounts**

We reviewed how UW institutions determined rental payment amounts for their lease agreements in effect with state employees as of December 2018. We reviewed whether UW institutions consistently and accurately considered the base rental amount determined through a DOA appraisal, adjusted the rental payment amounts biennially as required by DOA, and correctly applied discounts, if applicable.

We identified that 12 of 15 state-owned residential properties in which employees were required to reside in December 2018 were last appraised by DOA in 1995. Rental payments for the remaining three properties were not assessed because two properties were acquired subsequent to 1995 and one property, although state-owned in 1995, was not appraised.

***UW institutions will have undercharged an estimated \$24,000 for rental payments during 2019.***

We cannot determine from available information what the rental payment amounts would have been had DOA completed an appraisal in recent years. However, UW institutions were required to accurately implement all rental payment adjustments determined by DOA. We found UW institutions did not charge employees the full rental payment amounts because they did not accurately implement all adjustments. Based on rental payment amounts charged in December 2018, UW institutions will have undercharged an estimated \$24,000 for rental payments during 2019 for the 12 state-owned properties in which UW institutions required employees to reside.

***UW Madison did not consistently implement rental payment adjustments determined by DOA between 1998 and 2018.***

We found that UW-Madison did not implement all rental payment adjustments determined by DOA between 1998 and 2018 when it executed lease agreements with employees residing at agriculture research stations. According to the UW-Madison employee who managed most of the research stations, rental payment adjustments were determined independently, such as when there was a new occupant or when the employee believed there were inequities in rental payments among employees located at the research stations. As noted, because the rental payment amounts were not included in lease agreements and rental payment adjustments were verbally communicated, we were unable to assess the frequency or

consistency of the rental payment adjustments for employees that resided at the research stations.

We also found UW System Administration had leased an apartment to two employees who were not required to pay rent in exchange for managing UW events at the UW System President's residence. During our audit, UW System Administration indicated that the two employees no longer resided in the property as of September 2019.

### **Collecting Rental Payments**

***In December 2018, UW institutions collected \$4,700 in rental payments from UW employees who were required to reside in a state-owned property.***

UW employees who are required to reside in state-owned properties as a primary residence make rental payments either through biweekly payroll deductions or checks. In December 2018, UW institutions collected \$4,700 in rental payments from UW employees who were required to reside in the properties. The average monthly rental payment for these employees required to make rental payments was \$338 as of December 2018. For those lease agreements in effect as of December 2018, we found that all rental payments UW institutions expected had been received through June 2019.

### **Demonstrating Compliance with IRS Guidelines**

***UW institutions demonstrated compliance with IRS guidelines in only 3 of 16 lease agreements in effect as of December 2018.***

We found all of the 16 lease agreements in effect as of December 2018 related to 15 state-owned residential properties included at least a 50.0 percent rental payment discount. In order to not treat the discount amount as taxable income for the employee, UW institutions were required to comply with DOA policies and with IRS guidelines. Therefore, UW institutions should have documented in appointment letters, or comparable personnel information, that the employee was both required to reside in a state-owned property as a condition of employment and that residing in the property was necessary for the employee to properly conduct job responsibilities. However, we found that UW institutions demonstrated compliance with IRS guidelines in only 3 of the 16 lease agreements. An additional 12 lease agreements met one, but not both, of the requirements, and 1 lease agreement met neither requirement.

For the 12 lease agreements that met one but not both requirements, UW institutions identified a need for the employee to reside in the property to conduct job responsibilities. However, UW institutions did not state the requirement in appointment letters, or other comparable personnel information. For example, UW-Madison staff who managed most of the agricultural research stations indicated that the living arrangement is required for all employees, has been so for the last several decades, and is necessary to meet the demands of a fully operational farm. Several of the agriculture research stations required frequent measurements, monitoring for irrigation,



sampling, and animal feeding, which are conducted by research program managers or other employees in agricultural positions such as animal research technicians. UW institutions should clearly specify in appointment letters, or other personnel information, when they require an employee to reside in a state-owned property as a condition of employment.

***UW-Madison should not have provided a 50.0 percent rental payment discount and may need to consider tax implications for one employee.***

The lease agreement that met neither requirement was one UW-Madison executed with an employee residing at an agriculture research station who held a position unrelated to agriculture and commuted to work each day to conduct primary job responsibilities elsewhere. As a result, the employee did not conduct primary job responsibilities at the research station and was present only during evenings and weekends. According to UW-Madison staff, because UW-Madison desired that someone reside in the state-owned property, it offered the residence to this employee who opted to reside in it. If the employee was not required to reside in the state-owned property to conduct job responsibilities, UW-Madison should not have provided a 50.0 percent rental payment discount and may need to consider tax implications for this employee.

## **Improving Management of Residential Properties**

Although UW institutions executed some lease agreements for employees required to reside in state-owned properties as of December 2018, collected the rental payments in a timely manner, and identified business requirements for all but one employee required to reside in a state-owned property, UW institutions did not have sufficient documentation for all lease agreements and lacked appointment letters for all employees who were required to reside in the properties. Further, not all UW institutions correctly determined rental payment amounts in compliance with DOA policies.

***UW System Administration relied on UW institutions to ensure that rental payment adjustment information was accurately communicated.***

UW System Administration did not have a complete listing of all state-owned residential properties at the time of our audit. For example, only 2 of the 15 properties occupied as of December 2018 were included in the listing we initially received from UW System Administration. UW System Administration relied on UW institutions to ensure that rental payment adjustment information was accurately communicated to property managers, and it did not require confirmation that the institutions had implemented the DOA rental payment adjustments. If UW System Administration had done so, the rental payment adjustments on these properties may have been consistently and accurately applied.

The number of state-owned residential properties UW institutions maintain is small in comparison to the number of UW academic

facilities, yet specific requirements exist for residential properties. As a result, greater monitoring and oversight is needed to ensure that all requirements are consistently and accurately met. UW System Administration should maintain a current listing of properties leased to UW employees, develop policies and procedures for UW institutions to comply with all requirements when executing lease agreements with employees, and periodically take steps to ensure that UW institutions comply with these policies.

**☑ Recommendation**

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*We recommend the University of Wisconsin System Administration improve its management of state-owned residential properties, including by:*

- *complying with Department of Administration policies in executing lease agreements with employees who reside in state-owned residential properties;*
- *developing system-wide policies and procedures to promote consistent understanding and implementation of state policies within University of Wisconsin institutions in areas such as formally communicating when an employee is required to reside in a state-owned property as a condition of employment, determining rental payment amounts, and formally communicating expected rental payment amounts to employees;*
- *centrally tracking its state-owned residential properties in which University of Wisconsin institutions require employees to reside as a condition of employment;*
- *periodically monitoring whether University of Wisconsin institutions consistently follow Department of Administration and University of Wisconsin policies to manage state-owned residential properties; and*
- *reporting by April 10, 2020, to the Joint Legislative Audit Committee on the status of its efforts to implement these recommendations.*

## Employees Opting to Reside in State-Owned Properties

UW institutions managed 99 state-owned residential properties in which employees opted to reside in December 2018, including two UW-River Falls properties located at a research station and one property at the UW System President's residence.

***Lease agreement terms for UW employees opting to reside in 96 optional UW-Madison apartment buildings are treated similar to the terms for students.***

The 96 remaining properties are managed by UW-Madison as housing options largely for faculty and academic staff. The apartment buildings in which state employees resided are a subset of the residential housing options administered by UW-Madison's housing division that are located near the campus. Although some of UW-Madison's apartments are rented to students, the lease agreements and management of the agreements appear to be the same between UW employees and students. For example, UW-Madison staff identified that one schedule of rent is used regardless of the occupant. The apartments include one-, two-, and three-bedroom options with monthly rental payment amounts ranging from \$850 to \$1,400.

***Current DOA policies do not fully address how rental payment amounts should be determined for UW employees who opt to reside in apartments.***

The apartments leased to state employees on an optional basis were not part of the 1995 appraisals conducted by DOA. Because state employees reside in a state-owned property, statutory requirements for these properties apply to UW employees who opt to reside in them. However, we found that current DOA policies do not fully address how the rental payment amounts should be determined.

Instead, we found UW-Madison independently determined rental payment amounts based on periodic comparisons to area rental units. For example, UW-Madison last completed an evaluation of comparable rental payment amounts in 2014. Because UW employees pay the same amounts as others who opt to reside in a state-owned property, the employees are likely receiving no discount, or additional benefit, from UW-Madison.

### Recommendation

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*We recommend University of Wisconsin System Administration work with the Department of Administration to develop policies that specify how to determine rental payment amounts for employees who opt to reside in state-owned properties, including apartment buildings that may house both students and employees, and report by April 10, 2020, to the Joint Legislative Audit Committee on the efforts to implement this recommendation.*



## Future Considerations ■

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DOA's existing policies governing state-owned residential properties leased to state employees were established in 1975. As DOA considers changes, it should ensure that it has clearly defined the responsibilities of DOA and state agencies. For example, DOA should increase its responsibility for monitoring lease agreements with state employees. DOA should also identify potential statutory changes that may be needed to the frequency with which it should conduct appraisals and determine how it will ensure state employees that reside in state-owned properties are consistently charged rental payment amounts that reflect fair value. DOA should also consider establishing policies for determining rental payment amounts for employees who opt to reside in state-owned properties.

### **DOA Monitoring of State Employee Lease Agreements**

***DOA should take a more active role in monitoring lease agreements with state employees.***

DOA should take a more active role in monitoring lease agreements executed by state agencies to ensure they comply with DOA policies by obtaining and reviewing all lease agreements. As noted, DOA policies identify specific arrangements expected when state agencies execute lease agreements with state employees, including the amount and timing of rental payments; the responsibility for payment of utilities and performance of basic maintenance; the rights of each party to the agreement; and the period covered by the agreement. Involvement by DOA in reviewing lease agreements could help to ensure consistency of lease agreement provisions among state agencies, consider tax implications resulting from the

lease agreements, and monitor rental payment amounts and discounts. Finally, increased oversight of lease agreements state agencies execute with state employees is consistent with DOA's current statutory responsibilities for actively managing state agency facility lease agreements.

#### Recommendation

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*We recommend the Department of Administration:*

- *develop policies and procedures to monitor lease agreements state agencies execute with state employees who reside in state-owned properties, and*
- *report by April 10, 2020, to the Joint Legislative Audit Committee on the status of its efforts to implement this recommendation.*

## **Establishing Fair Values for Residential Properties**

In the absence of regular DOA appraisals or policies to address circumstances in which a rental payment amount could be revised between appraisals, we found state agencies had exercised increased discretion by establishing new base rental payment amounts or not implementing rental payment adjustments on the basis that the rental payment amounts did not reflect fair value. Although it will be important for DOA to conduct appraisals, it should reassess the frequency of appraisals to ensure that rental payment amounts consistently reflect fair value.

***DOA should exercise its authority and develop a process to adjust the base rental payment amount for factors that significantly affect the fair value of a property.***

Although statutes permit DOA to conduct appraisals more frequently for selected properties in certain circumstances, DOA did not exercise this authority when state agencies acquired new properties. DOA should specifically consider how to establish base rental payment amounts for the new properties and how to adjust the amounts for factors that significantly affect the fair value of a property. To do so, DOA could consider seeking statutory changes for conducting a new appraisal or relying on methods other than an appraisal that may be used to periodically revise the base rental payment amount. If DOA identifies that statutory changes are warranted, it should seek them.

DOA should also consider how base rental payment amounts are established for state-owned residential properties relative to appraised amounts. Following the 1995 appraisals, DOA calculated 7.0 percent of the property's appraised value and converted this to a monthly rental payment amount. DOA used 7.0 percent in this calculation based on the real estate investment returns of the State of Wisconsin Investment Board at the time. We note that IRS guidelines generally identify 5.0 percent of an appraised amount as a reasonable rental payment amount.

***DOA should work with state agencies to determine what tax implications, if any, result from instances in which the rent charged to employees who opted to reside in state-owned properties was less than fair value.***

Finally, under IRS guidelines, if an employee is not required to reside in a state-owned property, the difference between the fair value and rental payment amount may be considered taxable income for the employee. DOA should assess whether rental payment amounts reflect fair value and work with state agencies to determine what tax implications, if any, result from instances in which the rent charged to DNR and UW employees who opted to reside in state-owned properties was less than fair value.

#### **Recommendation**

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*We recommend the Department of Administration:*

- *reassess the frequency with which appraisals could be conducted in the future and seek statutory changes if it determines it should do so;*
- *assess whether there should be changes in how rental payment amounts are determined and periodically adjusted to ensure that state employees are charged rental payment amounts that reflect the fair value of the property;*
- *work with state agencies to determine the tax implications, if any, that result from instances in which rental payment amounts charged to employees who opted to reside in state-owned properties were less than fair value; and*
- *report by April 10, 2020, to the Joint Legislative Audit Committee on the status of its efforts to implement these recommendations.*

## Leasing to Employees Who Opt to Reside in UW Apartments

***DOA policies do not specifically address UW employees who opt to reside in state-owned properties.***

Because statutes require that DOA maintain policies that govern leasing state-owned residential properties and these properties are leased to state employees, we considered DOA policies in assessing UW-Madison's practice of leasing apartments to UW employees who opted to reside in them. However, as noted, we found that the policies do not specifically address UW employees who opt to reside in state-owned properties.

The apartment buildings in which UW employees reside were not appraised by DOA in 1995. Further, DOA's 1975 policy established a set rental payment amount for apartments and dormitories, but since there have been no policy revisions since 1975, these amounts are below the amounts UW-Madison currently charges employees. As a result, it is unclear how rental payment amounts should be determined to ensure employees are charged rental payment amounts that reflect a property's fair value as required by IRS guidelines.

It is important to consider how ch. 16, Wis. Stats., requirements apply to UW employees who opt to reside in these state-owned properties. As a result, DOA should develop specific policies for state-owned residential properties UW institutions may lease to UW employees, including how to determine rental payment amounts that reflect fair value.

### **Recommendation**

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*We recommend the Department of Administration:*

- *develop policies that specifically address how University of Wisconsin System Administration should determine rental payment amounts for employees who opt to reside in state-owned properties; and*
- *report by April 10, 2020, to the Joint Legislative Audit Committee on the status of its efforts to implement this recommendation.*

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## **Appendices ■**

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Appendix 1

**DNR Residential Properties as of December 2018<sup>1</sup>**

Property Type	Location	County	Discounted Monthly Rent Amount <sup>2</sup>
Education Center	MacKenzie Center	Columbia	\$339
State Fish Hatchery	Kettle Moraine Springs State Fish Hatchery	Sheboygan	456
State Fish Hatchery	Lake Mills State Fish Hatchery	Jefferson	368
State Fish Hatchery	Wild Rose State Fish Hatchery	Waushara	358
State Fish Hatchery	Wild Rose State Fish Hatchery	Waushara	330
State Fish Hatchery	Bayfield State Fish Hatchery	Bayfield	239
State Fish Hatchery	Bayfield State Fish Hatchery	Bayfield	239
State Fish Hatchery	C.D. Besadny Anadromous Fish Facility	Kewaunee	239
State Fish Hatchery	Brule River State Fish Hatchery	Douglas	162
State Forest	Kettle Moraine State Forest	Waukesha	463
State Forest	Kettle Moraine State Forest	Waukesha	449
State Forest	Kettle Moraine State Forest	Waukesha	391
State Forest	Kettle Moraine State Forest	Waukesha	391
State Forest	Kettle Moraine State Forest	Waukesha	341
State Game Farm	Poynette Game Farm	Columbia	358
State Park	Lake Kegonsa State Park	Dane	489
State Park	Devil's Lake State Park	Sauk	477
State Park	Kohler-Andrae State Park	Sheboygan	477
State Park	Devil's Lake State Park	Sauk	463
State Park	Big Foot Beach State Park	Walworth	430
State Park	Council Grounds State Park	Lincoln	409
State Park	Mirror Lake State Park	Sauk	370
State Park	Wyalusing State Park	Grant	331
State Park	Harrington Beach State Park	Ozaukee	326
State Park	Peninsula State Park	Door	316
State Park	Governor Nelson State Park	Dane	306
State Park	Potawatomi State Park	Door	301
State Park	Newport State Park	Door	229
State Park	Pattison State Park	Douglas	191
State Recreation Area	Richard Bong State Recreation Area	Kenosha	430
State Recreation Area	Hoffman Hills State Recreation Area	Dunn	272
State Recreation Area	Chippewa Moraine State Recreation Area	Chippewa	159

<sup>1</sup> Includes those properties occupied by DNR employees as a primary residence.

<sup>2</sup> These amounts reflect the actual monthly rental payments, which includes a 50.0 percent discount.



Appendix 2

**UW System Residential Properties That Required  
an Employee Reside as of December 2018<sup>1</sup>**

Property Type	UW Institution	County	Discounted Monthly Rent Amount <sup>2</sup>
Research Station	Stevens Point	Waupaca	\$450
Research Station	Platteville	Grant	389
Research Station	Madison	Columbia	387
Research Station	Madison	Columbia	365
Research Station	Madison	Oneida	359
Research Station	Madison	Columbia	350
Research Station	Madison	Columbia	350
Research Station	Madison	Columbia	345
Research Station	Madison	Wood	335
Research Station	Madison	Waushara	330
Research Station	Madison	Columbia	325
Research Station	Madison	Columbia	320
Research Station	Madison	Columbia	316
Research Station	Madison	Oneida	104
Apartment	System	Dane	— <sup>3</sup>

<sup>1</sup> Includes those properties occupied by employees in Wisconsin Retirement System–eligible positions as a primary residence.

<sup>2</sup> These reflect the actual monthly rental payments, which includes a 50.0 percent discount.

<sup>3</sup> No monthly rental payment amount was identified as services were provided in lieu of rental payments.



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## Responses ■

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STATE OF WISCONSIN  
DEPARTMENT OF ADMINISTRATION

Tony Evers, Governor  
Joel Brennan, Secretary

December 3, 2019

Joe Chrisman  
State Auditor  
State of Wisconsin, Legislative Audit Bureau  
22 East Mifflin Street, Suite 500  
Madison, WI 53703

Dear Mr. Chrisman:

This correspondence constitutes the Department of Administration's ("DOA") written response to the Legislative Audit Bureau's ("LAB") audit report of DOA's oversight of state-owned residential properties ("Audit Report"). DOA generally concurs with the findings of the Audit Report and has already begun taking steps to address its findings and recommendations. The remainder of this response will enumerate the Audit Report's recommendations and detail DOA's plans for addressing them.

**1. Ensure that state agencies provide confirmation that the CPI rent adjustments are implemented**

DOA is required by statute to fix rental rates for state-owned housing rental units based on fair market appraisals conducted every ten years, and then adjust those rental rates every two years based on changes in the consumer price index ("CPI"). DOA has been sending letters every two years to state agencies advising them of the applicable CPI adjustments. DOA is also required by statute to establish a system of rental policies and periodically review those policies for possible changes. In order to address this specific recommendation, DOA intends to include in its comprehensive review of its existing system of rental policies potential changes directing agencies to verify implementation of CPI-based rent adjustments.

**2. Work with agencies to reassess whether to retain state-owned residential properties, including recommending to SBC whether any properties should be sold, razed, or used for other purposes**

DOA is required by statute to include in its system of rental policies a procedure for review of the need to retain state-owned housing units and possible disposition of such units. DOA has existing procedures in place for state agencies to biennially report underutilized real property in accordance with section 13.48(14)(d) of the Wisconsin Statutes, which DOA then uses to evaluate whether such properties should be considered for disposition pursuant to section 16.848 of the Wisconsin Statutes. To the extent that agencies with state-owned residential properties consider such properties to be underutilized, such properties would be included in their biennial reports. In order to address this recommendation, DOA intends to include in its comprehensive review of its existing system of rental policies consideration of whether to include specific reference to the biennial underutilized real property report and/or whether a separate reporting mechanism should apply for state-owned housing units.

**3. Improve administration by complying with statutes by periodically reviewing and formally revising applicable policies**

DOA is required by statute to periodically review its system of rental policies for state-owned housing for possible changes. DOA's existing policy has not been revised since 1975. In order to address

this recommendation DOA intends to conduct a comprehensive review of its policy and submit proposed changes to the joint committee on finance as required by statute.

**4. Improve administration by tracking rental properties and monitoring rental payment amounts state agencies charge employees**

In order to address this recommendation, DOA intends to request from the relevant state agencies an up-to-date inventory of state-owned housing and copies of current lease agreements. DOA further intends to include in its comprehensive review of its existing system of rental policies consideration of changes necessary for agencies to report rent payments to DOA and any changes in their inventory of state-owned housing.

**5. Improve administration by complying with statutes to conduct appraisals of all state-owned residential properties**

DOA is required by statute to conduct appraisals of state-owned housing units every ten years. DOA acknowledges that no such appraisals have been conducted since 1995. By statute DOA is required to conduct its next set of appraisals in 2022. In order to address this specific recommendation, DOA intends to contract with appraisers to conduct the necessary appraisals in 2022. In DOA's exit interview with LAB, we explained the practical and financial difficulties of conducting such appraisals now, given that we are required by statute to conduct them again in three years.

**6. Ensure the system of rental policies sets forth clearly defined responsibilities of DOA and state agencies**

As discussed above, DOA intends to conduct a comprehensive review of its policy and submit proposed changes to the joint committee on finance as required by statute. As part of that review, DOA intends to consider changes to more clearly define the responsibilities of DOA and state agencies.

**7. Increase responsibility for monitoring lease agreements with state employees**

As discussed above, DOA intends to conduct a comprehensive review of its policy and submit proposed changes to the joint committee on finance as required by statute. As part of that review, DOA intends to consider changes to address this specific recommendation.

**8. Identify potential statutory changes as necessary regarding the frequency of appraisals**

DOA is required by statute to conduct appraisals of state-owned housing units every ten years. In order to address this recommendation DOA intends to review whether more frequent appraisals are appropriate. However, based on a preliminary analysis, DOA believes it is unlikely a statutory change is warranted, given the cost and administration required to conduct appraisals of such a large volume of properties. As part of its comprehensive review of the existing system of rental policies DOA will examine whether to recommend any other statutory changes.

**9. Consider how to establish base rental payment amounts for new properties and how to adjust amounts for factors that significantly affect the fair value of the property**

DOA is required by statute to fix rental rates for state-owned housing rental units based on fair market appraisals conducted every ten years, and then adjust those rental rates every two years based on changes in CPI. DOA is permitted by statute to reappraise the fair market value of a unit if it has been affected by a major renovation. In order to address the first part of this recommendation, DOA intends to include in its comprehensive review of its existing system of rental policies consideration of how to establish the fair market value of new housing units constructed or acquired in between the ten-year appraisals conducted on all housing units. With respect to the second part of this recommendation, DOA observes that section 16.004(8)(e)3. of the Wisconsin Statutes only permits two types of adjustments to rental rates in between the ten-year appraisals: 1) biennial adjustments based on CPI; and 2) adjustments

based on reappraisals when a property has been affected by a major renovation. As part of its comprehensive review of the existing system of rental policies DOA will examine whether to recommend any statutory changes to address this limitation.

**10. Work with state agencies to determine the tax implications, if any, that result from instances in which rental payment amounts charged to employees who opted to reside in state-owned properties were less than fair value**

IRS guidance establishes that employees who are offered employer-owned housing at below fair market value must report the difference in rent vs. fair market value as income, unless the employee is required to live in such housing as a condition of his/her employment. In order to address this specific recommendation, DOA intends to work with the relevant state agencies to determine which employees may currently be affected by such IRS guidance and the amount of rent they are paying to ensure they are properly reporting any income as part of their tax returns. DOA further intends to work with such agencies in conducting its comprehensive review of its existing system of rental policies to determine: 1) what documentation agencies should provide to establish that an employee is required to live in state-owned housing as a condition of their employment; 2) whether agencies should be permitted to charge employees below market rent to employees who are not required to live in state-owned housing as a condition of their employment; and 3) if so, what the appropriate reporting mechanisms should be to ensure that such employee's W-2s accurately reflect their income.

**11. Develop policies that specifically address how University of Wisconsin System Administration should determine rental payment amounts for employees who opt to reside in state-owned properties**

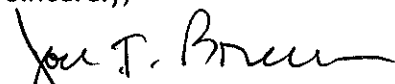
As stated above, as part of a comprehensive review of existing system of rental policies DOA intends to work with relevant agencies to determine whether employees should be permitted to pay below market rates when living in state-owned housing is not mandatory as a condition of their employment. If DOA and the agencies conclude that below market rents are appropriate, DOA will work with them to make proposed changes to its system of rental policies and submit them to the joint committee on finance for approval.

**12. Report to the Joint Legislative Audit Committee ("JLAC") by April 10, 2020 on the status of efforts to implement LAB's recommendations**

DOA will submit a report to JLAC by April 10, 2020 updating the committee on the implementation actions set forth in this response.

On behalf of DOA, I thank the LAB staff for the professional manner in which they conducted this audit.

Sincerely,



Joel Brennan  
Secretary



**State of Wisconsin**  
DEPARTMENT OF NATURAL RESOURCES  
101 S. Webster Street  
Box 7921  
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December 4, 2019

State Auditor Joe Chrisman  
Legislative Audit Bureau  
22 East Mifflin St. Suite 500  
Madison, WI 53703

Subject: State Residential Property Audit

Dear Mr. Chrisman:

Thank you for the opportunity to review the draft Legislative Audit Bureau (LAB) evaluation of the Wisconsin Department of Natural Resources' (DNR) administration of state-owned residential housing. The report provides information and datapoints about state-owned property, appraised values, conditions-of-employment, leases, and rents paid to the DNR by state employees living within state-owned residential housing.

I appreciate the work performed by LAB staff. Please accept my assurance to you and the Joint Legislative Audit Committee that the DNR will work with the Wisconsin Department of Administration to improve management of residential housing, appraisals, lease-terms, rent-calculations, and shared-services human resource protocols regarding employee designations, appointment letters, transfers, and bi-weekly withholdings.

While the issues identified have occurred over the course of multiple decades and administrations, the DNR takes the issues raised within this audit seriously, and I am committed to providing significant improvements in this administrative process. I look forward to providing you with information regarding process improvements on or before April 10, 2020 as outlined in your list of recommendations.

Thank you again for providing the opportunity to review the LAB state-owned residential housing audit report.

Sincerely,

A handwritten signature in black ink, appearing to read 'Preston D. Cole'.

Preston D. Cole  
Secretary-Designee  
Department of Natural Resources





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December 3, 2019

Joe Chrisman, Auditor  
Legislative Audit Bureau  
22 East Mifflin Street, Suite 500  
Madison, WI 53703

Dear Auditor Chrisman,

Thank you for the opportunity to respond to the Legislative Audit Bureau's (LAB) review of state-owned properties leased to state employees that are associated with the University of Wisconsin (UW) System.

LAB's review of state-owned properties was specific to state-owned properties managed by six state agencies and leased to state employees. As the LAB review notes, state statutes require that the Department of Administration (DOA) administer those properties by developing policies, conducting appraisals, and determining rental payment amounts to ensure rental payments state agencies charge state employees are based on the fair value of the properties. The UW System recognizes that there are opportunities for improved processes, procedures and documentation practices and agrees with the five recommendations detailed in the report. However, it is important to acknowledge that the review did not identify any instance of intentional fraud, waste and/or mismanagement, but rather opportunities to improve practices and protocols associated with a relatively low number (43) of the over 1,400 properties managed by the UW System, approximately 3% of the total inventory.

Recommendations from the report specific to the UW System, and the UW System response, are noted below:

- **LAB Recommendation 1: *Comply with Department of Administration policies in executing lease agreements with employees who reside in state-owned residential properties.***
  - UW System Response: The UW System will conduct a review of current Department of Administration policies to ensure compliance.
  
- **LAB Recommendation 2: *Develop system-wide policies and procedures to promote consistent understanding and implementation of state policies within University of Wisconsin institutions in areas such as formally communicating when an employee is required to reside in a state-owned property as a condition of employment, determining rental amounts, and formally communicating expected rental payment amounts to employees***
  - UW System Response: The UW System will develop an administrative policy and associated procedures that reflect state statutes and Department of Administration policies. Further, the UW System will provide guidance to the UW institutions on both documenting and communicating when an employee is required to assume residency in a state-owned property as a condition of employment.
  - Rental amounts shall be developed in accordance with state statute and Department of Administration guidelines.

- **LAB Recommendation 3: Centrally track its state-owned residential properties in which University of Wisconsin institutions require employees to reside as a condition of employment**
  - UW System Response: The UW System's Office of Capital Planning and Budget, in conjunction with Office of Human Resources, will develop an annual process for UW institutions to report to the UW System regarding those employees that are required to assume residency as a condition of employment.
  
- **LAB Recommendation 4: Periodically monitor whether University of Wisconsin institutions consistently follow Department of Administration and University of Wisconsin policies to manage state-owned residential properties**
  - UW System Response: The UW System will periodically monitor compliance with state statute and applicable policies.
  
- **LAB Recommendation 5: UW System work with the Department of Administration to develop policies that specify how to determine rental payment amounts for employees who opt to reside in state-owned properties, including apartment buildings that may house both students and employees.**
  - UW System Response: The UW System will work collaboratively with the Department of Administration on the best means to determine current and future rental payments, including defining a process for conducting a periodic assessment.
  - However, the UW System considers apartment buildings outside of this scope as there is no employment relationship associated with the university housing portfolio.

For all of the above recommendations, the UW System will report to the Joint Legislative Audit Committee on the status of its efforts to implement these recommendations by April 10, 2020.

Thank you for LAB's work on this review of state-owned properties managed by state agencies. We remain committed to working closely with DOA to ensure that the UW System is in compliance with state statutes and applicable DOA policies.

Respectfully submitted,



Ray Cross  
President