TO: WAFCA Member Executives and Financial Leaders

FROM: Linda A. Hall, Executive Director

DATE: November 1, 2017

RE: WAFCA Guidance for Nonprofit Providers of Rate-Based Services
Retained Surplus and 2017 WI Act 59

Thank you for your efforts to support our WAFCA advocacy for changes to the statutes governing rate-based services contracts for nonprofit providers of human services. We believe that these new statutory provisions that take effect for services beginning on January 1, 2018 will serve as a foundation for a better, more stable contracting environment for government and service providers into the future.

Special thanks to both our nonprofit and for-profit members who have given of their time and expertise as we pursued this initiative. Throughout this effort we sought to create a fair contracting environment for all providers -- setting a uniform expectation for nonprofit surplus retention, while preserving the existing policies regarding allowable profit in the for-profit sector.

The attached *WAFCA Guidance for Nonprofit Providers of Rate-Based Services* was developed in collaboration with our ad hoc consultation committee of member executives and financial leaders who have advised us over the past two legislative sessions. With county contracts pending, we wanted to ensure that members received analysis and information to guide decision making as we prepare for 2018. As noted in the *Guidance*, this document is not legal advice and should only be used in consultation with your own legal counsel.

Given the late date of budget passage, our purchasers in state and county government are still developing their plan for communicating these changes to all impacted parties. WAFCA anticipates further conversation with our government partners in the coming weeks as they continue their analysis. We hope that our WAFCA Guidance serves as a resource for all. In light of this ongoing discussion, please note that elements of the WAFCA Guidance may be amended or modified to address any questions and/or policy directives that emerge as the system continues to transition to these new contracting standards.

As partners in Wisconsin's human services system, we all understand the financing challenges that county and state government face and we are committed to providing efficient and effective services that deliver value for our communities. We believe that these statutory changes provide an opportunity for thoughtful and productive discussions that will ultimately improve and strengthen the system of care.

Thank you for all that you do on behalf of Wisconsin's children and families and thank you for the opportunity to serve you in your mission.

Wisconsin Association of Family & Children's Agencies
131 W Wilson Street #901 | Madison WI 53703
Office: 608.257.5939 | Fax: 608.257.6067 | wafca.org

WAFCA GUIDANCE FOR NONPROFIT PROVIDERS OF RATE-BASED SERVICES RETAINED SURPLUS - 2017 WI ACT 59

BACKGROUND: The new surplus retention statutes approved in the 2017-19 Biennial Budget (2017 WI Act 59) apply to all rate-based services regulated under WI Stats 46.036 (DHS), 49.34 (DCF), and 301.08 (DOC) provided by nonprofit agencies under contract with state or county government. The changes do not apply to for profit providers.[1]

The effective date of the new statutory provisions is for services delivered beginning January 1, 2018 (2017 WI Act 59, Sections 9406, 9408, 9420).

2017 WI Act 59 includes nonstatutory language describing the transition from the current reserves statutes to the new statutes effective for contract year 2018. (2017 WI Act 59, Sections 9106, 9108, 9120)

The guidance below prepared by WAFCA outlines the steps that nonprofit providers should take to align their 2018 rate-based service contracts with the new surplus retention statutes and to prepare for their 2017 & 2018 audits.

DISCLAMER: The information contained in this guidance is for the use of WAFCA members and has been prepared for general information purposes only. The information presented is not legal advice and should not be construed as such.

2018 RATE-BASED SERVICES CONTRACTS (Refer to Model Purchase of Services Contract (MPSC)

Checklist for providers in 2018 contracts:

- ☐ Establish agreed to audit requirement in light of new minimum audit threshold of $100,000 (Article 1, Sections 1.1, 1.3, MPSC)
- ☐ Set surplus retention percentage at 5% (Article 17, Section 17.2.2, MPSC)
- ☐ Cross reference the 6-month window for reclaiming surplus (Article 10, Section 17.2.4, MPSC)
- ☐ Make sure that there are no provisions in the contract granting purchaser control of the retained surplus.

[1] See Appendix 1, *WAFCA Client Memorandum: 2017 Wisconsin Act 59, Oct.27, 2017*, Page 5

☐ For Milwaukee County Contracts only – Determine and document whether surplus retention for a rate-based service is limited by statutory provisions under 46.036 (5m)(em); 49.34 (5m)(em); or 301.08(2)(em)5. (TANF maintenance of effort)

Minimum Audit Threshold Increases in 2018. The mandatory audit threshold is increasing from $25,000 to $100,000. Counties may still require a provider to conduct and submit an audit even if expenditures under the contract do not reach the new $100,000 threshold, however, that requirement should be clearly outlined in your contract and the contract should stipulate that audit costs, including the preparation of the surplus retention schedule, are deemed an allowable cost provided that the audit complies with the provisions of the *Provider Agency Audit Guide*.

Contracts Shall Allow the Provider to Retain up to 5%.[2] All rate-based services contracts should be set at 5% allowable surplus retention beginning with services provided as of January 1, 2018. The 5% surplus retention cap does not guarantee surplus; however, the contract must allow a provider to retain 5% (or a lesser amount if the surplus generated is less than 5% of the revenue received under the contract).

> Sample contract language: Article 17, Section 17.2.2 *The Provider may retain up to 5% of the revenue earned under this contract. The surplus is calculated based on allowable costs that the Provider incurs in performing the services provided under this contract*.

Purchaser has six months to claim excess surplus. Your contract should cross-reference the new statutory limit on reclaiming excess surplus. Once the provider gives written notice (in the form of the audit surplus retention schedule)[3] of a purchaser's proportional share of any surplus in excess of the 5% allowed under the contract, the purchaser has six months to issue a written request to the provider for the excess surplus. If the purchaser does not request it, the excess surplus defaults to the provider.

> Sample contract language: Article 10, Section 17.2.4 *The amount earned under this contract shall be confirmed through an annual audit. Non-profit Providers shall include a Surplus Retention Supplemental Schedule in their audit reports and this schedule shall be by contract or service category. Pursuant to Wis. Stat. 46.036 (5m)(b) [49.34(5m)b; 301.08 (2)(em)], the audit Surplus Retention Supplemental Schedule serves as notification to the Purchaser of any excess surplus beyond the statutory allowance of 5% of revenue earned under the contract. Purchaser shall claim excess surplus in writing within six months of receipt of audit. Unclaimed excess surplus becomes the property of the Provider.*

The retained surplus is the property of the provider.[4] Any surplus retained under the 5% allowed under the contract and any additional surplus unclaimed by a purchaser within six months of the notification regarding excess surplus becomes the property of the provider. Contracts should not contain any restrictions on expenditure or use of the retained surplus.

Document any Milwaukee County rate-based services that are not eligible for retained surplus. Under current statutes and the revised statutes, surplus may not be retained "from revenues that are used to meet the maintenance-of-effort requirements under the federal temporary assistance for needy families

[2] See Appendix 1, *WAFCA Client Memorandum: 2017 Wisconsin Act 59, Oct.27, 2017*, Page 3
[3] See Appendix 1, Page 4
[4] See Appendix 1, Page 4

program." While this is not new statutory language, providers may wish to include a clarifying provision, like the following, in their rate-based contracts.

> Sample contract language: Article 17, Section 17.2.2 *The Provider may retain up to 5% of the revenue earned under this contract. The surplus is calculated based on allowable costs that the Provider incurs in performing the services provided under this contract*. *Any rate-based service subject to disallowance of retention of surplus pursuant to Wis Stats 46.036 (5m)(em), 49.34 (5m)(em), or 301.08(2)(em)5 is identified by Purchaser below.*

2017 AUDITS & 2017 RESERVE SUPPLEMENTAL SCHEDULE

Key items for the 2017 agency or program audit:

- ☐ Reserve schedule for 2017 is prepared just as the 2016 reserve schedule.
- ☐ Purchasers may reclaim 2017 excess beyond the 5% (or whatever percent is included in your 2017 contract).
- ☐ Purchasers may reclaim cumulative excess beyond the 10%. (see nonstatutory language for determining 10% test)
- ☐ The reserve schedule serves as notification to purchaser of any excess reserve beyond the 5% annual and/or 10% cumulative reserve caps.
- ☐ The purchaser has 6 months from the date of receiving your audit to claim excess.
- ☐ **If you believe that you will have excess surplus beyond the 10%, *begin now* to engage purchaser** in a discussion about the history of the reserve and partnership with the purchaser going forward.

Reserve supplemental schedule for 2017. An agency's reserve supplemental schedule in the 2017 contract year audit should use the same template/methodology as the 2016 agency audit. For many providers this will mean that services are subject to the two-part test of 5% annual reserve (or the surplus allowance percentage set in the 2017 contract) and the 10% cumulative reserve test. Since 2010, rate-regulated services (out-of-home care) should only be subject to the 10% test (or a different percent if contracts set the retention rate lower). However, some auditors continued applying the two-part test to these services. For consistency, it is recommended that the 2017 audit reserve supplemental schedule be prepared similar to the agency's 2016 schedule.

10% test for calculating surplus. The 2017 reserve schedule should include the 10% test, which should be calculated as follows. If on December 31, 2017, the amount accumulated by a provider from all contract periods ending before January 1, 2018 for a rate−based service provided by the provider exceeds 10 percent of the provider's total earned revenue for that rate−based service in the year ending December 31, 2017 then purchasers will be eligible to claim the excess beyond the 10 percent.

Notification of excess reserve. As is true under current law, the reserve schedule contained within the audit serves as notification to the purchaser of their proportional share of the excess reserve.

6-month window to claim excess reserve. The purchaser has six months from the date of receipt of your audit to request the excess reserves. The request must be made in writing.

Engage purchasers now regarding potential excess reserve. If a provider has reason to believe that the reserve of any rate-based program or service will exceed the 10 percent test, the provider should begin communicating with purchaser immediately regarding the disposition of this reserve balance. All stakeholders should be aware that the 10 percent test is a flawed test in that it measures historical reserves relative to current year contract revenue, which may vary greatly from year to year. Many providers have been authorized by purchasers to retain excess reserves in past years. These historical agreements, modifications to program design, etc. should all be considered in the provider/purchaser conversation regarding potential purchaser requests for return of excess reserves. Contact WAFCA with further questions regarding the application of this test in the 2017 audit.

2018 AUDIT AND SURPLUS RETENTION SCHEDULE

Key items for the 2018 agency or program audit:

- ☐ Review whether contracts require audit in light of new audit threshold standards in contracts.
- ☐ 2018 surplus retention schedule includes only the 5% excess surplus test.
- ☐ The 5% is calculated based on revenue earned under the contract.
- ☐ The surplus retention schedule serves as notification to the purchaser of excess revenue and the purchaser has 6 months from the date of receiving the audit to claim excess surplus. Any unclaimed surplus defaults to the provider.

OTHER PROVISIONS - NEW ADMINISTRATIVE RULES

Rulemaking. The new statutes require the departments to engage in rulemaking to set the uniform surplus retention percentage at 5% or another uniform percentage rate (which could be more or less than the 5%). The departments are directed to consult with one another in the rulemaking process. Until such time as the departments approve new administrative rules, the uniform surplus retention percentage is 5% for all nonprofit rate-based services contracts under 46.036, 49.34 and 301.08.

Reinhart
Boerner Van Deuren s.c. Attorneys at Law

CLIENT MEMORANDUM

CONFIDENTIAL ATTORNEY/CLIENT COMMUNICATION

To: Wisconsin Association of Family & Children's Agencies

Date: October 27, 2017

Subject: 2017 Wisconsin Act 59

BACKGROUND

Pursuant to the request of the Wisconsin Association of Family & Children's Agencies ("WAFCA"), our firm reviewed certain provisions of 2017 Wisconsin Act 59 (the "Act")[1] relating to the Act's effect on rate-based service contracts for nonprofit providers and Wis. Stat. chs. 46, 49, and 301. In particular, we were asked to confine our review to four discrete issues as follows:

1. 5% Retained Surplus in Rate-Based Contracts with Nonprofit Providers. An appropriate interpretation of those provisions of the Act - and the resulting statutory provisions - that identify a 5% retained surplus in rate-based contracts.[2] In particular, whether those provisions require rate-based contracts to include a 5% retained surplus amount unless another amount is set by rule.

2. 5% Retained Surplus as Property of the Nonprofit Provider. An appropriate interpretation of those provisions of the Act - and the resulting statutory provisions - that state that "the [5%] retained surplus is the property of the nonprofit provider."[3] In particular, whether the statutory language is sufficiently clear to confirm that nonprofit providers have a property interest in and ownership of that retained surplus.

3. Notification of Excess Surplus. An appropriate interpretation of those provisions of the Act that relate to the written notifications that nonprofit providers must give regarding

---

[1] The provisions of the Act examined in this Memorandum first apply to contracts under which a provider commences performance on the effective date of the affected statute. *See* Act §§ 9306, 9308, and 9320. The effective date of these provisions is January 1, 2018. *See* Act §§ 9406, 9408, and 9420.

[2] *See* Act § 744c, Wis. Stat. § 46.036 (5m)(b)1.; Act § 923c, Wis. Stat. § 49.34(5m)(b)1.; Act § 1850f, Wis. Stat. § 301.08 (2)(em)2.

[3] *See* Act § 744(c), Wis. Stat. § 46.036 (5m)(b)1.; Act § 923c, Wis. Stat. § 49.34(5m)(b)1.; Act § 1850f, Wis. Stat. § 301.08 (2)(em)2.

amounts in excess of permitted surpluses.[4] In particular, whether those provisions, including the non-statutory provisions, require a particular form or manner of giving notice.

4. Distinction Between For Profit and Non-Profit Providers. Whether the provision of the Act examined in this Memorandum apply to both "for profit" and "non-profit" providers.

Our review of each of these issues focused on statutory construction and the body of law developed by the courts that relate to an appropriate interpretation of statutory language. That body of law includes the recognition of several principles applicable here, including:

- Courts Construe Statutes to Give Reasonable Effect to the Legislature's Intent. A court's goal in statutory interpretation is to discern the intent of the legislature. *Anderson v. MSI Preferred Ins. Co.*, 2005 WI 62, 281 Wis. 2d 66, 697 N.W.2d 73. Courts must construe statutory language reasonably; an unreasonable interpretation is one that yields absurd results or one that contravenes the statute's manifest purpose. *State v. Buchanan*, 2013 WI 31, 346 Wis. 2d 735, 828 N.W.2d 847.

- The Plain Language of a Statute Controls. Statutory interpretation is undertaken to determine the statute's meaning, which courts assume is expressed in the language chosen by the legislature. *State v. Soto*, 2012 WI 93, 343 Wis. 2d 43, 817 N.W.2d 848. If the meaning of the statute's language is plain, the court ordinarily stops its inquiry. *State v. Lamar*, 2011 WI 50, 334 Wis. 2d 536, 799 N.W.2d 758. Statutes are interpreted to give effect to each word and to avoid surplusage. *Klemm v. American Transmission Co., LLC*, 2011 WI 37, 333 Wis. 2d 580, 798 N.W.2d 223.

- Courts at Times Analyze Information in Addition to Statutory Language. Legislative intent is ascertained by considering the language of the statute, and, if necessary, the scope, history, context, subject matter, and object intended to be remedied or accomplished. *State v. Delaney*, 2003 WI 9, 259 Wis. 2d 77, 658 N.W.2d 416. History of a statute revealed in prior versions of the statute and legislative amendments to the statute are relevant to the statute's plain meaning. *Richards v. Badger Mut. Ins. Co.*, 2008 WI 52, 309 Wis. 2d 541, 749 N.W.2d 581.

- Legislative and Executive Resources May Inform the Appropriate Interpretation of a Statute. Because the Legislative Reference Bureau's analysis of a bill is printed with and displayed on the bill when it is introduced in the legislature, the Legislative Reference Bureau's analysis is indicative of legislative intent. *Dairyland Greyhound Park, Inc. v. Doyle*, 2006 WI 107, 295 Wis. 2d 1, 719 N.W.2d 408. Similarly, reports of the Legislative Fiscal Bureau were legislative history of value in determining legislative intent. *Juneau County v. Courthouse Employees, Local 1312, AFSCME, AFL-CIO*, 221 Wis. 2d 630, 585 N.W.2d 587 (1998). Also, long and uninterrupted practice under a statute, especially by the officers whose duty it was to execute it, is good evidence of its construction, and such practical construction will be adhered to. *Balcerzak v. Board of Fire and Police Com'rs for City of Milwaukee*, 2000 WI App 50, 233 Wis. 2d 644, 608 N.W.2d 382.

[4] *See* Act § 744e, 46.036(5m)(b)3.; Act § 923f, Wis. Stat. § 49.34(5m)(b)4.; Act § 1850f, Wis. Stat. § 301.08(2)(em)1.; *see also* Act §§ 9106, 9108, and 9120.

ANALYSIS

These principles of statutory construction and additional facts described below support the following arguments relating to the three issues described above.[5]

1. 5% Retained Surplus as a Required Term of a Contract. A compelling argument exists supporting the following position: the Act and the resulting statutes require rate-based contracts with nonprofit providers to include a provision mandating that, if revenues exceed allowable costs under a rate-based service contract for a certain period, then nonprofit providers shall retain from that surplus up to 5% of the revenue received under that contract unless another amount is set by rule.

   The Act changed existing statutory language concerning a 5% surplus as shown in the following redlined revisions:

   > "49.34 **(5m)** (b) 1. ~~Subject to subds. 2. and 3. and par.~~ ~~(em), if~~ If revenue under a contract for the provision of a rate−based service exceeds allowable costs incurred in the contract period, the contract shall allow the provider ~~may~~ to retain from the surplus ~~generated by that rate− based service~~ up to 5 percent of the ~~contract amount. A provider that retains a surplus under this subdivision shall use that retained surplus to cover a deficit between revenue and allowable costs incurred in any preceding or future contract period for the same rate−based service that generated the surplus or to address the programmatic needs of clients served by the same rate−based service that generated the surplus. This subdivision does not apply to a child welfare agency that is authorized under s. 48.61 (7) to license foster homes, a group home, as defined in s. 48.02 (7), or a residential care center for children and youth, as defined in s. 48.02 (15d)~~ revenue received under the contract unless a uniform rate is established by rule under subd. 5., in which case the contract shall allow the provider to retain the uniform percentage rate established by the rule. The retained surplus is the property of the provider."[6]

   Significantly, the Act changed the plain language of the statute from a permissive retention of a 5% surplus (*i.e.*, "may retain") to a description of a mandatory contract term relating to that surplus (*i.e.*, "contract shall allow"). Moreover, there is strong support for the argument that retention of "up to 5%" does not allow a nonprofit provider's contract partner to demand or set a percentage lower than 5% absent a separately promulgated administrative rule. The plain language of the statute mandates a 5% retention amount "unless" an amount different than 5% is set through a particular method, *i.e.*, a separately promulgated rule.[7] No other

---

[5] As will be shown, we believe that these arguments are strong. Even the existence of strong arguments, however, does not guarantee a certain outcome. There may be additional facts and laws that were not reviewed in the context of this analysis that could change the relative strength of these arguments. Moreover, the courts are the ultimate arbiter of the appropriate interpretation of the law. Variables concerning the courts, including, but not limited to, the judge who may decide such issues, the context in which these issues are raised to a court, and the location and jurisdiction of the court, may also affect the relative strength of these arguments.

[6] Substantively similar revisions were made to Wis. Stat. chs. 46 and 301 pursuant to the Act.

[7] Because the language concerning the 5% retention amount is statutory, it must not await the promulgation of administrative rules under Wis. Stat. § 49.34(5m)(b)5 to be in effect. Only a change to the 5% retention amount would require the promulgation of an administrative rule.

language exists to suggest that a nonprofit provider's contract partner has any other authority to set or demand a different amount.

Moreover, the analysis performed by the Legislative Reference Bureau ("LRB") and the Legislative Fiscal Bureau ("LFB") support these arguments. First, the LRB analysis to 2017 Assembly Bill 327, which addressed these issues and was enacted into law in the Act, confirms the distinction between the previous permissive language and the new mandatory language. Second, the LFB's analysis of 2017 Assembly Bill 327 and its senate counterpart, 2017 Senate Bill 255, recognizes that the 5% amount is not subject to change by a nonprofit provider's contract partner: "The proposed bill. . . would prevent the state or county from specifying a lower surplus retention percentage in the provider contract." The LFB's analysis also anticipates that certain nonprofit providers that currently are retaining less than 5% are able to retain additional surplus revenue.

In this context, the use of the phrase "up to" in advance of "5%" cannot reasonably be interpreted to grant a nonprofit provider's contract partner separate ability or authority (beyond the prescribed rule promulgation process) to set the retained surplus amount in a rate-based contract at less than, or any amount other than, 5%.

2. 5% Retained Surplus as Property of the Provider. A compelling argument exists supporting the position that the statutory language clearly confirms that nonprofit providers have a defensible property interest in and ownership of that retained surplus.

   The Act added the following language at the end of its description of the 5% retained surplus amount: "The [5%] retained surplus is the property of the provider." This plain language, which did not exist prior to the Act, unambiguously identifies the retained surplus as the property of the nonprofit provider. In addition to adding this language, the Act eliminated other language that previously limited the uses to which a nonprofit provider could put a surplus, *i.e.*, "A provider that retains a surplus under this subdivision shall use that retained surplus to cover a deficit between revenue and allowable costs. . ." The seemingly inescapable conclusion based on the plain language and the history of this statute, therefore, is that the retained surplus is owned by the nonprofit provider, to be used in any manner that is appropriate under applicable law.

3. The Act Does Not Proscribe a Certain Form of Notice for Excess Surpluses. A compelling argument exists supporting the position that there is not a proscribed form or manner of written notice that a nonprofit provider must give concerning amounts in excess of permitted surpluses.

   The Act created a process whereby a nonprofit provider notifies certain parties regarding a surplus in excess of 5% (or such other amount as set by administrative rule):

   > "If on December 31 of any year the provider's accumulated surplus from all contract periods ending during that year for a rate−based service exceeds the allowable retention rate under subd. 1., the provider shall provide written notice of that excess to all purchasers of the rate−based service."

   The Act did not further identify or describe this process, nor did the Act expressly delegate to further rulemaking the process for providing such notice. Under prior law that was repealed by the Act, the nonprofit provider was not required to provide any notice of an excess but

was required to return that excess to certain parties upon request. It is our understanding that, historically, surplus amounts have been identified by nonprofit providers in audit reports that they performed and submitted to the state or county, and that the state has not objected to this process.

The plain language of the written notice provision created by the Act does not require any particular form or manner of providing such written notice. The historical practice of nonprofit providers and the state or county in identifying surpluses in audits supports the continued use of those written documents as sufficient to satisfy the new written notice requirement. To help ensure that continuing this manner of providing written notice is recognized as satisfying the new statutory requirement, nonprofit providers may consider including a reference in the audit report to this new requirement. For example, the nonprofit provider may include in an audit a statement that "the information contained in page XX of this audit report comprises the provider's written notification as required by Wis. Stat. § § 49.34(5m)(b)4."

Please note, however, that the Act did not prohibit the state or a county from attempting to impose a particular manner or form of providing the required notice. Therefore, the appropriate manner of providing written notice may be further specified, at some point, in the contracts between the parties (*e.g.*, through a notice provision) or in a future administrative rule.

4. Those Portions of the Act Examined in this Memorandum Apply Only to Nonprofit Providers. A compelling argument exists that those portions of the Act that are examined in this Memorandum apply only to nonprofit providers.

   As it relates to the issues addressed in this Memorandum, the Act created and revised the law applicable to non-stock, nonprofit providers. *See* Wis. Stat. §§ 46.036(5m), 49.34(5m), and 301.08(2)(em). Those sections explicitly apply only to non-stock, nonprofit providers. The Act did not address or change the existing statutory provisions relating to "purchase of service" contracts for proprietary or "for profit" providers. *See* Wis. Stat. §§ 46.036(3)(c) ("For proprietary agencies, contracts may include a percentage add−on for profit according to rules promulgated by the department"), 49.34(3)(c), and 301.08(2)(c)3. Therefore, based on this plain language, it appears that the provision of the Act addressed in this Memorandum, including the provisions relating to contract terms and retained surpluses, do not apply to profit providers.