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Dr. Geoffrey H. Davis
District Superintendent
Hamilton-Fulton-Montgomery BOCES
Members of the Board of Education
2755 State Highway 67 • PO Box 665
Johnstown, N.Y. 12095

Report 2008M-83

Dear Dr. Davis and Board Officials:

A top priority of the Office of the State Comptroller is to help local government, school district and Board of Cooperative Educational Services (BOCES) officials manage their resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support their operations. The State Comptroller oversees the fiscal affairs of BOCES statewide, as well as BOCES' compliance with relevant statutes and observance of good business practices. This fiscal oversight can identify opportunities for improving BOCES operations and BOCES Board of Education governance.

In accordance with these goals, we conducted an examination of Hamilton-Fulton-Montgomery BOCES' controls over employee classification for the period July 1, 2006 through June 30, 2007. The objective of this examination was to determine whether BOCES officials ensured that they enrolled only valid public employees in the New York State and Local Employees' Retirement System (ERS). Elected officials, public officers and employees of participating public employers are eligible for membership in ERS and, as members, receive credit for their paid public service. We conducted this examination pursuant to the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

Background and Methodology

The Hamilton-Fulton-Montgomery BOCES is headquartered in Johnstown, New York, and provides more than \$22 million in shared educational services to 15 school districts in Fulton, Montgomery and Hamilton Counties. The BOCES is governed by a Board of Education (Board), which comprises seven members. Board members are elected by members of the boards of education of the component school districts to serve for three-year terms. The Superintendent is the chief executive officer of the BOCES and is responsible, along with other administrative staff, for the day-to-day management of the BOCES under the direction of the Board. The District's budget for the 2006-07 fiscal year was more than \$25 million, of which about \$10.8 million was for payroll expenditures. The BOCES currently employs a total of 371 professional and support staff.

BOCES districts employ a wide variety of people to deliver educational and technical services to component school districts. It is important for BOCES officials, along with other public employers, to properly classify workers as "employees" or "contractors." Public employers that participate in ERS put their employees on the payroll, which requires withholding and contributing toward employees' payroll

taxes and benefits, including insurance and other benefits. Public employers must also enroll their full-time employees in ERS and may enroll those part-time employees who elect enrollment. Enrolled employees earn service credits during their period of public employment, which may entitle them to a pension from ERS. Contractors are not eligible to join ERS or to receive service credits. The Office of the State Comptroller's *Financial Management Guide for Local Governments*¹ (Guide) provides information to help distinguish between independent contractors and employees. ERS provides its own checklist of indicators² that can help BOCES officials make this determination correctly.

During this examination, we interviewed BOCES officials, reviewed employment records and agreements, and examined payroll and service hour data. We asked BOCES officials to provide documentation of the process they use to verify that they comply with relevant guidelines for classifying employees and enroll only valid employees in ERS. We also asked officials to show us evidence to support the employee status of any ERS-enrolled individual who provides professional services that are commonly obtained from a contractor or consultant. The results of our examination have been discussed with BOCES officials and their comments have been considered in preparing this report.

Results of Examination

Public employers must take reasonable steps to ensure that the persons they enroll in ERS are actually eligible for membership. Our tests of enrollment at BOCES revealed that five attorneys, all partners in a private law firm, were improperly enrolled in ERS during the 2006-07 fiscal year because they were contractors, rather than valid public employees. As a result, taxpayers have subsidized payments to ERS on behalf of independent contractors who are not entitled to pension benefits. These attorneys, who were on the BOCES payroll as full-time employees, also worked substantially less than the 1,157 days that BOCES reported to ERS: the five partners actually worked 196 days, for which they were paid a total of \$234,000. We attribute the improper enrollment of these independent contractors to weaknesses in the BOCES' controls over the process for classifying workers' status. BOCES officials have since suspended the pay of these attorneys, and the Board adopted a resolution on March 10, 2008, ending the attorneys' services for the 2007-08 fiscal year. BOCES officials have also indicated that they plan to strengthen controls over worker classification processes.

Classification of Independent Contractors as Employees

Generally, the key in determining whether an individual is an employee or a contractor is information that provides evidence of both the entity's degree of control over the worker and the work, and the worker's degree of independence from the entity. These issues should be assessed by the employer when it makes a determination as to whether an individual should be considered an employee and whether service credit information should be reported to ERS.

Behavioral control is demonstrated when the entity has a right to direct and control how the worker performs the tasks he or she was hired to do. Examples include work-related instructions (e.g., when and where to do the work; what resources are provided by the employer; which workers to hire to assist with the tasks; how to account for time worked; what sequence to use in doing the work), and other indications, such as a job description, that the entity has the right to control details of the worker's performance as an employee. Training that the entity provides to ensure work is performed in a particular way is further evidence of behavioral control of an employer over an employee, as is a periodic evaluation of work performance. By contrast, contractors are generally hired to provide services without receiving explicit instructions from the entity regarding how to go about performing the services. Contractors usually obtain their own training.

¹ *Financial Management Guide for Local Governments*, Volume Two, Subsection 8.4020, page 1, issued December 1992

² This checklist, entitled *Distinguishing Between an Employee and an Independent Contractor*, is available from ERS.

Financial control is demonstrated when the entity has the right to control the business-related aspects of the worker's job. Examples include how the worker is paid, the extent of the worker's investment in facilities used in performing the services, and the worker's ability to make his or her services available to others by advertising, maintaining a visible business location and seeking business opportunities. Whereas an employee is generally paid a salary or wages on an hourly/weekly basis, a contractor is usually (but not always) paid a flat fee or according to a schedule determined by a contract. Further, employees do not invest in their work facilities, nor do they generally maintain a business location to offer the services to others that they provide to the entity. Contractors also realize a profit or a loss in performing their services for the entity, but employees do not. Finally, multiple engagements to provide professional services are a possible indicator of a client/contractor relationship.

BOCES and other public employers that participate in ERS must follow the above guidance, which is further described in the Guide. If a worker is correctly classified as an employee, the public employer must enroll full-time employees in ERS, and enroll part-time employees in ERS if they elect membership. ERS provides an *Employer's Guide*,³ which specifically instructs public employers not to pay independent contractors on their payroll and not to enroll these individuals in ERS because they are not eligible for membership.

To determine whether BOCES officials had properly classified worker status and had enrolled only valid public employees in ERS, we examined the classification status of five individuals who performed professional services for the BOCES during the 2006-07 fiscal year. We determined that five attorneys, all partners at the same private law firm, were improperly enrolled in ERS because they did not meet the criteria for employee status; rather, these professionals were independent contractors.

During the 2006-07 fiscal year, the five attorneys were paid a total of \$234,000 to provide contract negotiation services related to the terms and conditions of the BOCES services to its component school districts. Although they were all on the BOCES payroll as full-time employees, the BOCES did not exercise the level of behavioral and financial control over their work that characterizes an employer/employee relationship.

- None of these attorneys had fixed hours
- BOCES management did not oversee the attorneys' work
- The attorneys' law firm hired other staff to work on contract negotiation services for the BOCES
- The attorneys did not submit time sheets to BOCES officials
- The attorneys did not work on BOCES premises, but generally worked at their own offices
- The attorneys used their own office equipment to do the work
- The partners' law firm continued to maintain a private law practice, offering legal services to the public, while they were enrolled in ERS as BOCES employees.

Based on the degree of independence these attorneys had from the BOCES, the manner in which they did their work and billed for their time, and their operation of a private legal practice during this period, we conclude that these individuals were independent contractors. As such, they should not have been enrolled in ERS, because they were not public employees, and are not eligible for public employee pension benefits paid for by taxpayers. When we informed BOCES officials of our determination, they promptly removed the attorneys from the BOCES payroll. Further, the Board adopted a resolution on March 10, 2008 ending the attorneys' services 2007-08 fiscal year.

³ The *Employer's Guide* is available from OSC in hard copy and also is included on the OSC website.

We also determined that the attorneys' work time was significantly over-reported. Each one of these attorneys was paid and reported to ERS for having worked 231.4 days – almost full time – for the BOCES 2006-07 fiscal year ended June 30, 2007. However, according to data provided to the BOCES by the attorneys' law firm, each partner worked only a fraction of the reported time, ranging from 71 days for one partner to four hours for another partner. In total, the five attorneys were paid \$234,000 for working the 1,157 days that BOCES reported to ERS as their work time.

We attribute the incorrect classification of these attorneys and their improper enrollment in ERS to inadequate controls over the BOCES classification process. Such a process helps to prevent the enrollment of non-employees in ERS, and should include procedures that require officials to document how the decision about a worker's classification was determined and to maintain evidence of the individual's classification status. At the BOCES, we found that officials lacked procedures for the proper classification of workers, and did not consistently review the status of all individuals who provided services to the BOCES. BOCES officials had no documentation of any review that was done of the five attorneys' classification status; in fact, BOCES officials had no job description for these individuals. Unless BOCES officials strengthen controls over worker classification, they will remain at higher risk of incorrectly classifying workers and improperly enrolling non-employees in ERS. BOCES officials have indicated that they will correct the weaknesses we identified in controls over the classification process.

Recommendations

1. BOCES officials should formally notify ERS that the BOCES-related service credit for the five attorneys identified in our report should be removed from ERS because these individuals are not BOCES employees.
2. BOCES officials should strengthen internal controls over the classification of workers, and regularly monitor the continuing effectiveness of these control measures, to ensure that only valid public employees are enrolled in ERS.

Sincerely,

Steven J. Hancox
Deputy Comptroller
Division of Local Government
and School Accountability