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Mr. Carmen A. Grant
District Superintendent
Members of the Board of Education
Niagara Falls City School District
607 Walnut Avenue
Niagara Falls, NY 14301

Report 2008M-89

Dear Mr. Grant and Board Officials:

A top priority of the Office of the State Comptroller is to help local governments and school district 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 school districts statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight can identify opportunities for improving school district operations and Board of Education governance.

In accordance with these goals, we conducted an examination of Niagara Falls City School District's controls over employee classification for the period July 1, 2006 through June 30, 2007. The objective of this examination was to determine whether school district 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 Niagara Falls City School District (District) is located in Niagara County. The District is governed by a Board of Education (Board), which comprises nine elected members. The Board is responsible for the general management and control of the District's financial and educational affairs. The Superintendent of Schools is the chief executive officer of the District and is responsible, along with other administrative staff, for the day-to-day management of the District under the direction of the Board.

There are 11 schools in operation within the District, with approximately 7,500 students enrolled. The District also operates a Community Education Center and an administrative building and employs approximately 1,250 full-time and part-time employees. The District's budgeted operating expenditures for the 2006-07 fiscal year were \$163 million, which were funded primarily with State aid, real property taxes and grants.

The District, like most school districts, employs a wide variety of people to provide educational and technical services. It is important for school district 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 school district officials make this determination correctly.

During this examination, we interviewed District officials, reviewed employment records and agreements, and examined payroll and service hour data. We asked District 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 District 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 the District revealed that an attorney was improperly enrolled in ERS during the 2006-07 fiscal year because she was a contractor rather than a valid public employee. As a result, taxpayers have subsidized payments to ERS on behalf of an independent contractor who is not entitled to pension benefits. This attorney, whom the District hired in 1999, was on the District's payroll as a full-time employee, was paid \$42,827 in salary, and was provided with \$5,817 in health insurance benefits in the 2006-07 fiscal year. The attorney whom the District classified as an employee was not an employee: she did not have a standard work day or hand in time sheets, and District management did not oversee the attorney's work. In fact, she works full-time from her own office at her father's law firm. In addition, she did not have an employment contract and did not receive vacation leave, sick leave or personal leave - all benefits true District employees receive. We attribute the

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.

improper enrollment of this independent contractor to weaknesses in the District's controls over the process for classifying workers' status. District officials indicated that they will make the corrections needed to legitimize the attorney's employee status. This change in status can occur only if the attorney meets the employee criteria established in the Guide.

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 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.

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.

The District and other public employers that participate in ERS must follow the above guidance, which is further described in the Guide. ERS also 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 District officials had properly classified worker status and had enrolled only valid public employees in ERS, we examined the classification status of an attorney who performed professional services for the District during the 2006-07 fiscal year. We determined

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

that this attorney, whom the District classified and paid as an employee serving as Assistant School District Attorney, was improperly enrolled in ERS because she did not meet the criteria for employee status; rather, this professional was an independent contractor.

The District obtains legal services from three attorneys, two of whom the District pays as independent contractors. In 1999, the District hired the third attorney, the daughter one of the above attorneys (a named principal in a private law firm), put her on the payroll, and enrolled her in ERS as a full-time employee. District payroll records show that she works for the District seven hours per day, 260 days per year. District officials stated that her main duty is to run the Superintendent's disciplinary hearings, and that she reports to the Superintendent. This attorney was paid a salary of \$42,827 in the 2006-07 fiscal year, and received health insurance benefits for this period totaling \$5,817. Her salary for 2007-08 is listed as \$43,427. Our examination concluded that the District did not exercise the level of behavioral and financial control over this attorney's work that characterizes an employer/employee relationship.

- The attorney did not have fixed hours or a standard work day.
- District management did not oversee the attorney's work; although she reportedly works under the Superintendent's direction, one District official told us she actually works under the direction of her father.
- The attorney does not belong to a collective bargaining unit or have a contract with the District, so there is no documentation of the benefits she receives as a District employee.
- The attorney did not submit time sheets or any other substantiation of work performed to District officials.
- The attorney did not have an office on District premises; except for the hearings, she generally worked at her father's law firm.
- The attorney did not receive vacation leave, sick leave or personal leave - all benefits that other District employees receive.
- On her recently written resume, this attorney states that she is in private practice with her father's law firm; she does not state that she is a full-time employee with the District.

Based on the degree of independence this attorney had from the District, the manner in which she did her work, and the lack of documentation to indicate the hours she worked or the assignments she completed, we conclude that this individual was an independent contractor and not a full-time District employee. As such, this attorney should not have been enrolled in ERS. Because she was not a public employee, she is not eligible for public employee pension benefits paid for by taxpayers. When we informed District officials of our determination, they indicated that they planned to make the changes necessary to create an employer/employee relationship with the attorney going forward.

We attribute the incorrect classification of this attorney and her improper enrollment in ERS to inadequate controls over the District's worker 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 District, 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 District. District officials had no documentation of any review that was done of this individual's classification status, and the District's job description for the attorney's position is very general. Unless District officials strengthen controls over worker classification, they will remain at higher risk of incorrectly classifying workers and improperly enrolling non-employees in ERS. District officials have indicated that they will correct the weaknesses we identified in controls over the classification process.

Recommendations

1. District officials should formally notify ERS that prior District-related service credit for this attorney should be removed from ERS because this individual is not a District employee. If District officials want to initiate an employer/employee relationship with the attorney in the future, they should ensure the attorney meets all the criteria for employee status, as outlined in the Guide.
2. District 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