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Date: January 12, 2012

To: Audit, Finance & Enterprise Committee

From: Jennifer Ruttman, City Auditor

Subject: Citywide Audit of the Use of Temporary Labor & Independent Contractors

Pursuant to the Council-approved Audit Plan, the City Auditor's office has completed a citywide audit of the Use of Temporary Labor & Independent Contractors. The final report is attached. Due to the unusually wide scope of this audit, and the numerous departments involved, our findings and recommendations are presented in summary format, but are listed in more detail in the accompanying appendix. For the same reasons, individual responses are not incorporated into the report. However, each affected department has agreed to implement corrective actions as recommended.

We will perform a follow-up review in approximately 1 year, to verify that the planned corrective actions have been implemented effectively.

Please feel free to contact me if you have any questions.

AUDIT REPORT

CITY AUDITOR

Report Date: January 12, 2012
Department: Citywide
Subject: Use of Temporary Agency Labor & Independent Contractors

OBJECTIVE

The objective of this audit was to evaluate the use of temporary agency workers and personal services contractors for compliance with applicable policies, regulations, and contract terms.

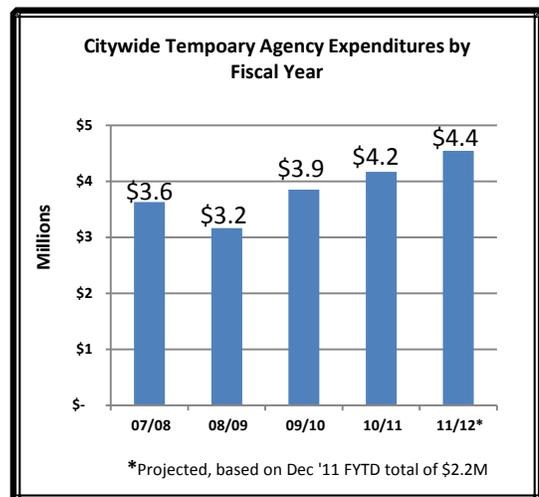
SCOPE & METHODOLOGY

The audit scope included transactions and contracts dated during fiscal years 09/10 & 10/11. To meet the audit objective, we reviewed applicable policies, contracts, invoices and other payment documents; interviewed City staff members; and performed other testing and analyses as necessary.

BACKGROUND

Increased Demand for Services

In recent years, the use of temporary labor and independent contractors has increased significantly as the City has struggled to maintain service levels with fewer full-time employees. Other causes for the increase include the inability to recruit qualified applicants for certain positions; the need to back-fill positions held by City employees who have been temporarily reassigned to the CityEdge project; and, in some cases, a lack of adequate succession planning that resulted in the use of former employees as “temps”, either to train others to do their jobs, or to do the work themselves until the position was filled.



Governance

The use of both temporary workers and independent contractors is governed by several management policies, as well as numerous citywide and departmental guidelines. (A list of these authoritative documents is provided in Appendix B.) These policies and guidelines have been implemented to ensure that the City complies with state statutes as well as federal employment rules established by the Department of Labor (DOL) and Internal Revenue Service (IRS). Specific rules are also included to reduce the risk of temporary workers claiming that they meet “common law” employee criteria and are therefore entitled to the same benefits as City employees. To avoid such claims, it is critical to maintain a “non-employee like” relationship with temporary agency workers as well as with independent contractors.

Processes, Roles & Responsibilities

Temporary agency workers are classified into 4 Groups, based on the liability for injury associated with the assigned job title. Groups I – III include only those workers placed in City of Mesa position titles, which range from administrative to light industrial to medium industrial

classifications. Group IV includes only those workers placed in specific non-City position titles within the Arts & Cultural and Parks, Recreation & Commercial Facilities (PRCF) Departments.

Groups I – III temporary workers are requested through a process administered by a Coordinator in the Human Resources (HR) Department. The Coordinator is responsible for processing the request and working with the agency to place the appropriate worker. This includes ensuring that required documents are completed, and that verifications such as fingerprinting, background check, E-verify, required licenses/certifications, MVD check if driving, etc. are performed prior to the start of work. The Coordinator also monitors problems with workers or the agencies, tracks hours worked to ensure compliance with break-in-service requirements, reviews invoices to verify that the correct pay and markup rates are charged, and reports temporary labor expenditures to management.

The Group IV temporary agency positions utilized by the PRCF and Arts & Cultural Departments, as well as certain technical positions that are filled through specialized agencies, are not managed by HR, but are instead administered at the department level. However, since most of the same rules apply to these workers, it is important that each of these departments have effective procedures in place to monitor compliance.

For certain personal services that are not typically performed by employees, and are project-oriented or based on specific deliverables, and meet other applicable criteria, departments may enter into personal services contracts with qualified independent contractors, rather than obtain these services through an employment agency. However, it is important that these arrangements meet the criteria for a contract relationship as opposed to an employment relationship.

OBSERVATIONS

Compliance testing was performed on a sample basis and focused primarily on the following:

- Job titles & minimum qualifications
- Background checks & other screening
- Compensation
- Time cards & payment procedures
- Break-in-service rules
- Contract existence & document retention
- Contract content
- Contract payments
- Employee vs. independent contractor status

During the audit, we found that the majority of City staff members involved with the use of temporary agency workers and independent contractors did not have a strong understanding of the applicable policies and procedures; and as a result, compliance has been inconsistent. Since these policies were specifically designed to protect the City from various liabilities, non-compliance has exposed the City to an increased risk of loss. Examples of potential liabilities include injuries, common-law employee claims, unemployment compensation, overpayment for services, and many others.

In some departments, the same individuals have served as temporary agency workers and independent contractors simultaneously. This may present a problem if the total number of hours worked is not carefully monitored, as any hours over 40 in a week would be considered overtime under FLSA rules.

We also found that some departments do not have adequate controls in place to ensure that personal services contracts are appropriately managed. For example, many contracts that were said to exist could not be located. In some of those cases, we were able to confirm that the department did not actually have a contract, but procured the services based only on verbal agreements. Among the sampling of contracts we were able to review, we found several indications that better controls are needed. A few examples include: payments that significantly exceeded the contract limits; contracts that the departments acknowledged did not accurately reflect the intent of the parties; and contracts that were written so poorly as to be non-executable.

CONCLUSION

In our opinion, the use of temporary labor and personal services contractors citywide did not always comply with applicable policies, regulations, and contract terms during the audit period. The primary cause for this was an overall lack of awareness and understanding of the various requirements along with inconsistent management oversight. Please see Appendix A for a more complete summary of the audit findings.

RECOMMENDATIONS

We have communicated in detail with the affected departments regarding our specific findings and we have made individualized recommendations to address them. These recommendations can be summarized as follows:

1. Department directors should take steps to increase staff members' awareness and improve their understanding of (and compliance with) the various City policies and procedures applicable to the use of temporary agency employees and independent contractors.
2. Department directors should take steps to improve the level of due diligence and attention to detail exercised by City staff when engaging in contracts for personal services. This includes verifying that contracts contain appropriate terms and limits, monitoring deliverables and payments for compliance with those terms and limits, and ensuring that contracts are retained in accordance with applicable document retention standards.

Each of the affected departments has agreed to implement the recommendations presented to them. We will follow up in approximately 1 year to determine whether all corrective actions have been implemented effectively.

Appendix A – Summary of Audit Findings

Requirement	Finding
<p><u>Job Titles & Minimum Qualifications</u></p> <p>To comply with City policy, temporary employees in Groups I – III must be placed in City job titles; and all temporary workers should be assigned job titles that are appropriate for the duties performed. These workers should meet the minimum qualifications specified in the corresponding City job descriptions.</p> <p>The underlying premise of this policy is that City job descriptions, along with their corresponding minimum qualifications and assigned pay ranges, have been vetted by HR and deemed appropriate.</p> <p>The minimum qualifications (i.e. education, licenses, certifications, etc.) specified in City job descriptions have generally been established to provide assurance that an individual assigned that job title has the knowledge and expertise needed to safely and effectively perform their duties.</p>	<p>When the job duties assigned to temporary workers did not correlate to existing City job titles, some departments used non-City titles. Since no established pay ranges existed for these titles, the departments assigned pay rates at their own discretion. While assigning an alternate title might have been a reasonable course of action under the circumstances, some type of market research or other analysis should have been performed (and documented), to ensure the minimum qualifications, job duties, and pay rates associated with these titles were appropriate. In addition, the deviation from policy should have been approved by the City Manager or designee. This would have called attention to the fact that the existing policy was not meeting the needs of the City and was in need of revision.</p> <p>In other cases in which the workers' assigned job duties did not correlate to existing City job titles, the workers were placed in job titles that were not appropriate for their duties, and for which they did not meet the minimum qualifications. According to staff members, this was done because the policy required that a City title be used, but no appropriate City title existed.</p> <p>We also noted a temporary agency worker who did not possess a license that was necessary to fully perform the duties associated with the job.</p>
<p><u>Background Checks and Other Screening</u></p> <p>Fingerprinting and background checks are required for temporary agency workers and independent contractors that may, in the course of their duties, come into contact with minors, disabled or homebound persons, or work in security sensitive areas.</p> <p>Driving record checks and/or drug screening may be required for some temporary workers and/or contractors, depending upon the type of work performed and the associated risks.</p> <p>In addition, most of the City's service contracts</p>	<p>Some independent contractors were not fingerprinted or background checked, although their work involved contact with minors. For various reasons, the responsible City staff members had erroneously assumed that the checks had been done.</p> <p>The City engaged independent contractors to transport City assets from one location to another; however, their driving records and insurance coverage were not checked.</p>

Requirement	Finding
<p>require that the contractor maintain (and provide proof of) specific types and amounts of insurance coverage, to limit the City's liability.</p>	
<p><u>Compensation</u></p> <p>According to City policy, the "standard" pay rate for a temporary agency worker is equivalent to 5% below the "1" step for the range assigned to the job title, unless an exception is approved by the department director.</p> <p>This policy was intended to provide some level of assurance that temporary worker pay rates would be appropriate for the job duties and would not exceed the rates paid to City employees for the same type of work.</p>	<p>The majority of temporary agency workers used by the City are paid more than the standard rates. In some cases, the rates paid to temporary agency workers exceeded the maximum pay rates (or "7" step) associated with the positions, with no written director-level approval on file.</p>
<p><u>Time Cards and Payment Procedures</u></p> <p>Temporary agency workers are expected to record the date, start time, finish time, time off, and total hours on their time cards. The cards should then be reviewed and signed by their direct supervisors.</p> <p>Temporary agencies are required to provide Workers Compensation coverage for their employees. This coverage only applies to incidents that occur during working hours.</p> <p>Invoices received from temporary agencies must be compared to information recorded on time cards, to ensure the number of hours billed for each worker is accurate, and that any overtime billed is valid. Depending on the agency, a two or four hour minimum may be billed for an individual who works less than the minimum number of hours specified in the contract.</p>	<p>These procedures were not always followed. In some cases, the supervisor recorded the workers' hours on the time cards in a manner that did not reflect the actual hours worked. While the total number of hours recorded was accurate, the times of day were not. Reporting that workers are working on City premises when they are not, or reporting that they are not working on City premises when they are, exposes the City to increased risk for workers compensation claims and other liabilities.</p> <p>In one case, overtime was erroneously paid, when staff failed to adequately scrutinize an invoice. In another case, the rules regarding the minimum number of billable hours were applied incorrectly, resulting in overpayment.</p>
<p><u>Break-In-Service Rules</u></p> <p>Breaks in service are required after 12 consecutive months of work by a temporary agency worker, unless the individual never works 20 or more hours/week. The length of the required break, if any, varies by Group classification and depends on the number of hours worked per week. These requirements were implemented to reduce the risk of "common law employee" claims. <i>(This term is</i></p>	<p>In one department, several temporary workers that were engaged through a specialized agency (not monitored by HR) did not take the required breaks in service, because the responsible City staff members were unaware of the requirements of Management Policy 331. These "temporary" employees worked full-time for multiple years without any break in service.</p>

Requirement	Finding
<p><i>explained below, under "Employee vs. Independent Contractor Status".)</i></p>	
<p><u>Contract Existence & Document Retention</u></p> <p>According to City policy (MP 332): "An independent contractor will sign a contract for each arrangement/project specifying the terms of the relationship."</p> <p>Effective contract administration requires that staff has adequate knowledge of the existence and terms of all contracts and is actively monitoring them. This includes maintaining copies of all contracts in accordance with applicable document retention standards.</p> <p>If a contract cannot be found, it cannot be enforced, and payments made in association with it cannot be verified as appropriate. In addition, the City would be unable to comply with Freedom of Information Act requests and could be in violation of applicable records retention laws.</p>	<p>Several departments engaged individuals to provide various services based only on verbal agreements. Unfortunately, without a written contract, deliverables and compensation may not be clearly defined or understood, potential liabilities may not be mitigated, and overpayments are more difficult to prevent and/or detect.</p> <p>Some departments asserted that they had written contracts, but they were unable to produce copies of those contracts when we requested them. In many cases, staff members were uncertain as to whether or not there was a contract.</p>
<p><u>Contract Content</u></p> <p>When entering into a contract, sufficient care must be taken to ensure the terms are written exactly as intended and that all parties to the contract understand and agree to those terms. In addition, for a contract to be enforceable, its terms must be fully executable.</p>	<p>Some departments did not pay sufficient attention to detail when engaging individuals with limited services contracts; and as a result, they signed contracts that did not accurately reflect the intent of the parties. In some cases, the terms were written so poorly that they were non-executable. In our opinion, neither City staff nor the contractors intended to misrepresent the terms of these agreements, but they failed to apply the appropriate level of scrutiny prior to signing.</p>
<p><u>Conflicts of Interest</u></p> <p>State law prohibits the City from procuring services from an employee, except as a result of a public, competitive bidding process.</p>	<p>A City employee's business was retained to provide services to another City department, without engaging in a competitive bidding process. This was discontinued in 2010, and the individual involved no longer works for the City.</p>
<p><u>Contract Payments</u></p> <p>Payments for contracted services should be made only in accordance with the terms of the contract. These terms generally specify the timing of</p>	<p>Some departments made payments that were not in accordance with applicable contract terms. In some cases, payments were made prior to full performance by the contractor. In other cases, payments were made well in excess of the maximum</p>

Requirement	Finding
<p>payments in relation to performance, and often include a minimum and/or maximum amount payable under the contract.</p> <p>Prior to renewing an annual contract for professional services, City departments should review actual expenditures for the current and prior years, to ensure the maximum amount payable under the contract will be sufficient to meet the City's needs for the duration of the contract period. If the need for services exceeds the expected maximum during the contract period, the contract should be amended in writing to provide for the increase.</p>	<p>specified in the contract.</p> <p>In one department, staff members repeatedly underestimated the need for services and the corresponding maximum amount payable when submitting an annual professional services contract to the City Manager for approval. There was ample historical data available that, if reviewed, would have indicated that the actual expenditures were much higher than the contract amount.</p>
<p><u>Employee v. Independent Contractor Status</u></p> <p>The IRS requires that workers be classified as employees or independent contractors, based on 3 basic characteristics – behavioral control, financial control, and type of relationship. If, based on these characteristics, the IRS determines that a contractor should actually be classified as an employee, the City could be liable for fines, penalties, and employment taxes, retroactive to the date the work began.</p> <p>In addition, the individual might then have a plausible basis for a “common law employee” claim. Such claims, which stem from several precedent-setting court cases in the 1990's, could expose the City to liability for retroactive employee benefits in addition to the tax liabilities noted above.</p> <p>To avoid these and other risks, services that fall within the scope of City job classifications, if not provided by employees, should be provided by temporary agency workers through one of the City's contracted agencies. These workers should then be monitored for compliance with break-in-service requirements.</p> <p>Limited Services Contracts are designed to be used only when personal services are required to meet specific, finite deliverables within a specific time period. They are not appropriate for procuring ongoing services, and should not be used when deliverables cannot be specifically defined.</p>	<p>Some departments have engaged individuals as contractors on a full-time basis for extended periods of time, providing services more in the manner of employees than that of independent contractors. The length of service and the extent of direction provided by City staff are of particular concern, as these are considered critical factors in the IRS analysis.</p> <p>In some cases, there are additional risks, such as when the work being performed is associated with a high risk of industrial injuries. When the work is performed by employees or temporary agency workers, this risk is mitigated through appropriate workers' compensation coverage. However, when using contractors, the risks associated with injuries must be addressed with appropriate contract language, including not only insurance provisions and liability waivers, but also detailed terms of service delivery that are specifically designed to protect the City from other risks.</p> <p>In one case we reviewed, administrative services typically provided by employees were obtained through a limited services contract, instead of through the temporary agency; and when the individual's services were no longer required, the State of AZ deemed the City responsible for unemployment compensation.</p>

APPENDIX B – Authoritative References

Management Policies

- Management Policy 331, Temporary Agency Workers on Assignment to the City
- Management Policy 332 – Use of Independent Contractors
- Management Policy 325 – Interns

Citywide Guidelines, Procedures, and Forms (issued by HR)

- Supervisors Guide to Temporary Workers with the City of Mesa
- Background Check Guidelines
- Temporary Agency Workers 1 Year of Service Tracking Procedures
- Group IV Temporary Agency Worker Processes
- Temporary Agency Worker Requisition Form
- HR InsideMesa Webpage Guidelines

Departmental Guidelines and Procedures

- Parks, Recreation & Commercial Facilities Department Guideline - Temporary Worker & Dual Employment
- Parks Division – Job Descriptions for Temporary Agency Workers
- Arts & Cultural Department Job Descriptions for Temporary Agency Employees

Contracts

Citywide Contract for Temporary Worker Services (Contract #2005152)

Commercial Facilities Contracts for Temporary Employment Services (Contract #2009167)

Statutes

Arizona Revised Statute 38-503: Conflict of interest; exemptions; employment prohibitions.