Report of the Vermont State Auditor

August 31, 2015

WORKER MISCLASSIFICATION

Action Needed to Better Detect and Prevent Worker Misclassification

Douglas R. Hoffer
Vermont State Auditor
Rpt. No. 15-07

Mission Statement

The mission of the Auditor's Office is to hold state government accountable. This means ensuring that taxpayer funds are used effectively and efficiently, and that we foster the prevention of waste, fraud, and abuse.

Douglas R. Hoffer
STATE AUDITOR

STATE OF VERMONT
OFFICE OF THE STATE AUDITOR

August 31, 2015

Addressees (see last page of letter)

Dear Colleagues,

Vermont workers who are misclassified as independent contractors do not receive protections and benefits to which they are entitled. Furthermore, these workers must pay the social security and Medicare tax that is normally paid by employers. Employers that misclassify have an unfair business advantage against those employers that abide by the law, because the employers that misclassify do not pay for workers' compensation insurance, unemployment taxes, or the employers' share of the social security and Medicare taxes.

In recent years, the Vermont General Assembly has 1) increased both the amounts and types of penalties that may be assessed against employers that misclassify their workers; 2) enacted new requirements for state contracting procedures to assure that they will minimize misclassification of workers as independent contractors; and 3) authorized increased resources to investigate worker misclassification. In 2012, the Governor created a Task Force charged with combating worker misclassification.

Because of this emphasis on deterring worker misclassification, we decided to 1) assess the actions that the Vermont Department of Labor (VDOL) has taken to detect and address possible worker misclassification and 2) assess whether the Department of Buildings and General Services (BGS) and the Agency of Transportation (AOT) have implemented required state contracting procedures designed to minimize worker misclassification by companies that contract with the State.

VDOL has taken steps to address worker misclassification. For example, VDOL is developing an education and outreach campaign on worker misclassification, and the department has worked with business and labor groups to propose statutory changes to existing law.

Although the department was charged with leading the Governor's Task Force on Employee Misclassification, it did not convene any meetings from June 2013 to July 2015. Further, the 2012 executive order that created the task force specified that agencies and departments should engage in timely enforcement, but VDOL has failed to enforce unemployment insurance penalties for worker misclassification, which have been statutorily required since 2010, and some workers' compensation penalties as well. VDOL attributed the lack of enforcement to a need to establish additional

administrative rules for the statutory penalty provisions related to worker misclassification, but the department has yet to accomplish this after five years.

Our audit found that VDOL's Unemployment Insurance (UI) division lacks reliable performance data for its field audit program, and the Workers' Compensation (WC) division's primary system for recording investigation case data has limited functionality and contains data anomalies and duplicate case information. These issues have limited VDOL's ability to measure the impact its UI field audit and WC investigation programs have had on detecting misclassification. The UI data was flawed as a result of data entry errors, a lack of supervisory review of the data input, and the absence of documented procedures for compiling the field audit data. The WC problems occurred for a variety of reasons, including a lack of documented procedures for entering information in its database system.

Further, the WC division records show 30 investigations first started in 2011 have not been completed, and 134 cases categorized as active are assigned to investigators no longer employed by VDOL. The lack of follow through on these cases occurred because WC has not developed protocols for case reassignment and case management practices, such as standards for maximum caseloads per investigator and timely case completion.

BGS and AOT have developed procedures and forms designed to meet statutorily required contracting procedures, but gaps remain. Neither entity consistently applied the procedures they had developed to all contracts over $250,000 as required, nor validated information that was reported by state contractors regarding worker classification violations within the past 12 months and subcontractors to be used on a project. Consequently, BGS and AOT risk contracting with businesses that violated state employment laws in the previous 12 months or are currently misclassifying workers, leaving workers on state projects without the coverage they are entitled to by law.

This report contains a variety of recommendations to improve the actions taken by VDOL, BGS, and AOT to address worker misclassification. In commenting on a draft of this report, BGS and AOT outlined various actions they planned to undertake in response to the recommendations. Some of VDOL's comments on the draft report were inconsistent or in conflict with our findings and did not address most of the recommendations. Reprints of the comments of all three are included in appendices to this report and our evaluation of VDOL's comments are included in the reprint of the VDOL comments.

I would like to thank the management and staff at VDOL, BGS, and AOT for their professionalism and cooperation during the course of the audit.

Sincerely,

Doug Hoffer

Doug Hoffer
Vermont State Auditor

ADDRESSEES

The Honorable Shap Smith
Speaker of the House of Representatives

The Honorable John Campbell
President Pro Tempore of the Senate

The Honorable Peter Shumlin
Governor

Ms. Annie Noonan
Commissioner
Vermont Department of Labor

Mr. Michael Obuchowski
Commissioner
Vermont Department of Buildings and General Services

Ms. Sue Minter
Secretary
Vermont Agency of Transportation

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Introduction

Worker misclassification[1] arises when an employer improperly classifies an employee as an independent contractor versus an employee. In Vermont and nationally, there appears to be an ongoing problem caused by those employers that attempt to avoid or minimize workers' compensation premiums and avoid paying unemployment insurance taxes by treating employees as independent contractors rather than employees. As a result, misclassified workers do not receive the protections and benefits to which they are entitled, and in addition they must pay the social security and Medicare taxes normally paid by the employer.

Meanwhile, employers have incentive to misclassify their workers to reduce the costs of workers' compensation insurance, state and federal unemployment taxes, and the employer's share of the social security and Medicare taxes. This creates an unfair business advantage, allowing businesses that misclassify to avoid these costs and undercut employers that do abide by the law.

In recent years, the Vermont General Assembly has 1) increased both the amounts and types of penalties that may be assessed against employers that misclassify their workers; 2) enacted new requirements for state contracting procedures to assure that they will minimize misclassification of workers as independent contractors; and 3) authorized increased resources to investigate worker misclassification.

On September 8, 2012, Governor Shumlin signed Executive Order No. 08-12, establishing the Governor's Task Force on Employee Misclassification. This task force was charged with combating worker misclassification in Vermont and reporting its findings to the Governor on January 15 of each year.

Because of the emphasis placed on deterring worker misclassification by the General Assembly and the Governor, we decided to 1) assess the actions that the Vermont Department of Labor (VDOL) has taken to detect and address possible worker misclassification, including the extent that the VDOL collaborates internally as well as externally with other state and federal

[1] Worker misclassification is also referred to as employee misclassification. While we have chosen to use the term worker misclassification for purposes of consistency in the report, there will be times that the term employee misclassification is used, such as when using the actual title of a specific task force.

agencies, and 2) assess whether the Department of Buildings and General Services (BGS) and the Agency of Transportation (AOT) have implemented required competitive bidding and contract oversight procedures designed to minimize worker misclassification by companies that contract with the State.

Appendix I contains the detail on our scope and methodology. Appendix II contains a list of abbreviations used in this report.

Highlights: Report of the Vermont State Auditor

Worker Misclassification: Action Needed to Better Detect and Prevent Worker Misclassification

(August 2015, Rpt. No. 15-07)

Why We Did this Audit	Because the Governor and the General Assembly have placed emphasis on deterring worker misclassification, the State Auditor's Office (SAO) decided to review state programs that have a role in addressing worker misclassification. Specifically, we decided to 1) assess the actions that VDOL has taken to detect and address possible worker misclassification, including the extent that the VDOL collaborates internally as well as externally with other state and federal agencies, and 2) assess whether BGS and AOT have implemented required competitive bidding and contract oversight procedures designed to minimize worker misclassification by companies that contract with the State. This report's first objective is organized by three major groupings pertaining to 1) VDOL, 2) VDOL's unemployment insurance (UI) program, and 3) VDOL's workers' compensation (WC) program.
Objective 1 Finding - VDOL	VDOL has addressed some of the actions in the charge to the task force on worker misclassification established by executive order in 2012, including developing an outreach campaign. However, the department did not convene task force meetings from June 2013 to July 2015 and there was limited information regarding what, if any, actions resulted from a task force meeting in 2012 and one in 2013. It's not clear why VDOL did not schedule any task force meetings for two years, as additional work remains, such as evaluating existing misclassification enforcement by agencies and departments. Further, the executive order specified that agencies and departments should engage in timely enforcement, but VDOL has failed to enforce unemployment insurance penalties for worker misclassification, which have been required by statute since 2010, and some workers' compensation penalties as well. VDOL indicated that they have not enforced all misclassification penalties because the department has not established the rules[2] for UI and WC to enforce these penalties. Massachusetts and New York have convened tasks forces to address worker misclassification and have reported better agency cooperation, more efficient use of resources, and significant monetary recoveries. Scheduling additional meetings to address the other required task force actions may improve prevention and detection of worker misclassification.

[2] A rule is an agency statement of general applicability which implements, interprets, or prescribes law or policy.

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Objective 1 Finding – UI	UI field audits identify worker misclassification, but improvements to audit selection could increase detection. Federal guidance encourages states to utilize audit selection criteria that suggest noncompliance (i.e., targeted selection criteria), but UI selected 71 percent of its 2014 audits on a random basis. According to the U.S. Department of Labor Office of the Inspector General (U.S. DOL OIG),[3] those states that used targeted audit selection criteria rather than simply selecting employers at random were the most effective at detecting noncompliance with UI tax laws. UI and SAO identified errors in the field audit performance data reported to the U.S. DOL for calendar year 2014, including errors in number of audits conducted and number of misclassified employees. These errors occurred for a variety of reasons, including data entry errors, lack of supervisory verification of data input, and lack of documented procedures for compiling field audit data for the performance reports. The extent of the impact of all of these errors has not been determined by UI, but UI has contacted the U.S. DOL to request how to report the errors once the full impact has been determined. Without reliable data UI cannot evaluate the performance of the field audit activity. Further, management relied on inaccurate performance data to make decisions about the field audit program, increasing the risk that incorrect decisions were made.
Objective 1 Finding – WC	WC records show 30 investigations first started in 2011 have not been completed, and 134 cases categorized as active are assigned to investigators no longer employed by VDOL. These problems occurred because WC has not developed protocols for case reassignment and case management practices, such as standards for maximum caseloads per investigator and timely case completion. Additionally, the primary database used by WC to record summary case investigation data has limited functionality, contains data anomalies and duplicate case information, and is missing data for a substantial number of records. The combination of these circumstances has hampered management's ability to monitor investigation status and to ensure that all investigations are completed and, when warranted, penalties enforced. Further, management's ability to measure the program's effectiveness is limited.

[3] U.S. Department of Labor- Office of the Inspector General Report No. 03-99-006-03-315, *Adopting Best Practices Can Improve Identification of Noncompliant Employers for State UI Field Audits*.

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Objective 2 Finding	As required by Act 54 (2009) Section 32(a), BGS and AOT implemented some procedures to minimize instances of worker misclassification on state projects with costs greater than $250,000. These procedures included use of 1) a self-reporting form for contractors to identify any worker classification violations within the past 12 months and 2) a subcontractor reporting form for identifying subcontractors to be used on a project and their workers' compensation insurance carriers. However, neither BGS nor AOT validated the information provided by contractors. The state's internal control guide for managers identifies verification as a common control activity for determining the completeness, accuracy, and validity of information. AOT and BGS indicated their belief that VDOL was responsible for providing information to them about entities that have had previous violations. In particular, BGS indicated that a 2012 Memorandum of Understanding (MOU) among VDOL, Department of Financial Regulation (DFR), AOT, and BGS only requires BGS to collect the forms. However, the MOU does not mention these forms. BGS has concerns about its authority to request VDOL information and AOT stated concern about the efficiency of accessing VDOL information. Since the 2012 MOU did not address validating information provided in the forms, and AOT and BGS believe it is VDOL's responsibility to provide this information to them, clarification and agreement among VDOL, DFR, AOT, and BGS regarding this is warranted. In addition, BGS and AOT did not implement procedures for all projects greater than $250,000. For example, BGS obtained the contractor self-reporting form only for competitively bid projects, explaining that the self-reporting form is generally obtained during the competitive bidding process and those projects that aren't competitively bid do not follow the bidding processes. AOT did not obtain either form for personal services contracts because procedures for non-construction projects had not been updated to incorporate the Act 54 revisions and forms. Regardless, the information collected via these forms is required for all projects greater than $250,000. Failing to obtain the required information and lacking a process to verify the information that is obtained, the State is at risk of contracting with vendors that have violated employment law and is missing opportunities to prevent instances of worker misclassification on state projects.

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What We Recommend	We make various recommendations to VDOL, including: 1) schedule Misclassification Task Force meetings and ensure that all of the required actions are addressed, 2) increase the use of targeted selection criteria for UI audits, 3) develop procedures for better data reliability and case management, and 4) develop the administrative rules necessary to assess all misclassification penalties authorized by the General Assembly. We make several recommendations to BGS and AOT, primarily to 1) amend the self-reporting form to require bidders to provide all information regarding any of the contractor's past violations, convictions, or suspensions related to employee misclassification, 2) consistently apply their procedures to all types of contracts, and 3) work with VDOL and DFR to validate information provided by the contractor as it relates to worker classification violations and subcontractor's workers' compensation insurance coverage.

Background

Worker Misclassification

In general, worker misclassification occurs when an employer improperly classifies a worker as an independent contractor instead of an employee.[4] According to the Workers' Compensation Employee Classification, Coding and Fraud Enforcement Task Force, employment status creates very different obligations and rights under workers' compensation and unemployment insurance law than does the status of independent contractor.[5] The task force noted that workers' compensation and unemployment insurance programs, occupational safety and health laws, and labor standards generally apply to employees but may not apply to independent contractors. In addition, employers are legally required to pay certain payroll taxes and withhold state and federal income taxes from wages paid to employees, but need not do so when paying independent contractors. (See Appendix III for additional information on the effect of misclassification on employees and the financial advantages to employers that misclassify employees).

Misclassification of workers is a violation of state law. Several state agencies have a role in addressing misclassification. However, two programs administered by VDOL, Unemployment Insurance (UI)[6] and Workers' Compensation (WC), have significant responsibility for detecting and addressing misclassification and have statutory authority to issue administrative penalties to employers who misclassify workers. In addition, the Department of Buildings and General Services (BGS) and the Agency of Transportation (AOT) were required to develop new state contracting procedures to minimize the incidents of misclassification of workers as independent contractors.

[4] An employer is a legal entity that is required by law to furnish unemployment insurance coverage and/or workers' compensation insurance to one or more individuals.

[5] Final Report of the Workers' Compensation Employee Classification, Coding and Fraud Enforcement Task Force, dated November 16, 2009.

[6] Unemployment insurance is also referred to as unemployment compensation. For the purpose of consistency within our report, we have chosen to utilize only the term unemployment insurance.

Unemployment Insurance Program

Vermont's unemployment insurance law was enacted in 1936 and was fully operative by 1938. The primary objective of unemployment insurance is to alleviate the hardship of lost wages for employees who become involuntarily unemployed and who are willing to accept suitable jobs that are available. Generally for UI, an employee is defined as someone who is compensated for work by an employer unless the employer can demonstrate that A) the individual is free from control or direction over the performance of their services both in the contract and in fact, B) the services are provided outside the usual course of business or the services are outside of all the places of business of the enterprise for which the service is performed, and C) the individual is customarily engaged in an independently established trade or business.[7]

The unemployment insurance program is a federal-state partnership and is managed by Vermont with oversight from the United States Department of Labor (U.S. DOL) Employment and Training Administration. VDOL administers the unemployment insurance program and is responsible for assigning employer tax rates.

Costs of the UI program are borne entirely by the employers. Employers pay two taxes for unemployment insurance. One tax is paid to VDOL and is used solely for the payment of benefits. The second tax is paid to the U.S. Treasury and is used to pay for the cost of administering the program, to make loans to replenish state trust funds, and to pay for the federal share of the cost of any extended benefits program that may be in effect.

VDOL has a UI field audit[8] section that consists of ten UI field auditors and one audit chief. Field auditors perform a number of functions related to the UI program. These functions include examining employment records for the purpose of establishing an employer's unemployment and health care contribution liability, conducting compliance audits, collecting unreturned unemployment insurance forms, and investigating allegations of fraudulent or inappropriate unemployment claims. The compliance audits verify the status of individuals as employees and the designation of payments as wages to insure proper payment of unemployment taxes. 21 V.S.A. §1314a provides the authority for VDOL to impose penalties on those employers that have been found to misclassify their employees. Appendix IV of this report

[7] UI refers to this as the "ABC" test in its Employer Information Manual.

[8] A field audit is a systematic examination of a subject employer's books and records, using generally accepted auditing standards and procedures, covering a specified period of time during which the employer is liable for reporting under the law.

contains the details on penalties VDOL may assess against those employers that do not properly classify their employees in accordance with UI's definition of employee.

Workers' Compensation Program

Vermont law requires employers to have workers' compensation coverage for their employees. Workers' compensation is a statutorily mandated no-fault insurance system that provides various benefits to an employee who suffers a work-related injury or occupational disease. The benefits include wage replacement, medical treatment, and vocational rehabilitation. Workers' compensation benefits are limited by law, but the program assures that injured or sick employees receive basic remedies for work injuries while avoiding costly negligence suits. Employers purchase this insurance policy from insurance carriers who determine the employers' premiums. VDOL does not set the rates for these premiums. Generally, under Workers' Compensation rules, an employee is defined as someone who is compensated for work by an employer unless the employer can demonstrate that the hired person performed a job that was not similar or in connection with the employer's business and the employer has no direction or control over the hired person's work.

The primary role of VDOL's Workers' Compensation Program is to adjudicate disputes between injured employees and the employer's insurance company. The program is also charged with enforcing Vermont's workers' compensation laws, including penalizing employees who commit claimant fraud and penalizing employers who fail to purchase workers' compensation insurance.

The Workers' Compensation Administration Fund was created to provide the funds necessary to administer the program. The fund consists of contributions from employers, based on the Workers' Compensation Assessment Rate. Beginning July 1, 2015, the rate for employers is 1.45 percent of the employers' premiums for workers' compensation insurance and 1 percent of workers' compensation losses during the preceding calendar year for those employers that self-insure.

The division's Workers' Compensation Investigations' Program consists of four investigators and one chief investigator. These investigators pursue fraud and misclassification, issue stop-work orders against employers that do not have workers' compensation insurance coverage for their employees, and make administrative penalty recommendations to enforce compliance with the law. 21 V.S.A. Chapter 9 provides the authority for VDOL to impose penalties on those employers that have been found to misclassify their employees. Appendix IV of this report contains the details on penalties

VDOL may assess against those employers that do not properly classify their employees in accordance with WC's definition of employee.

Required Procedures for State Contracting

BGS and AOT administer various contracts for construction and non-construction services. Among the various types of contracts are:

- Construction – A construction contract involves construction, improvement, repair and maintenance of state buildings, highways, bridges, and airports. Examples are asbestos abatement at the Waterbury State office complex, bridge repair, or parking lot improvements at the Chittenden Regional Correctional Facility.

- Personal Service – BGS's personal services contracts involve contracting for various services such as software development. AOT's personal service contracts are primarily focused on retainer-style contracts that engage contractors for an unknown number of unspecified projects requiring a certain discipline, such as consulting engineering or construction inspection services. The projects stipulate a maximum limiting amount.

- Maintenance Rental Agreement – Maintenance rental agreements are annual contracts to accomplish scheduled roadway and bridge preventive maintenance, preservation and repair projects. The instrument is a non-determinate location/non-determinate quantity type contract in which contractors provide rates for various locations throughout the state where they are interested in working. Once a work project is developed, contractor selection is then based on the lowest rates, experience, and availability of contractors for the particular location.

- Aviation Contract – Aviation contracts may be construction or personal service contracts that are administered through the aviation division. They may be awarded through AOT's contract administration for construction projects, through the use of a consultant if specialized knowledge is required, or by using the Federal Aviation Administration if a federal grant is obtained for the project.

In 2009 the legislature enacted Act 54 Section 32(a) which required the Agency of Administration (AoA)—who identified BGS as its designee—and AOT to establish procedures to assure that state contracting procedures and contracts were designed to minimize the incidents of misclassification by state contractors on projects with a total project cost of more than $250,000. The Act required the contractors to provide, at a minimum, all the following:

1) Detailed information to be included with the project bid on any violations by the contractor related to classification of employees.

2) A list of subcontractors[9] on the job and by whom those subcontractors are insured for workers' compensation purposes.

3) For construction and transportation projects over $250,000, a payroll process by which during every pay period the contractor collects from the subcontractors or independent contractors a list of all workers who were on the jobsite during the pay period, the work performed by those workers on the jobsite, and a daily census of the jobsite.

In 2011, Act 50 required that, as a part of the payroll process, the contractor would confirm that its subcontractors have the appropriate workers' compensation coverage for all workers at the job site.

[9] "Subcontractor" also means entities hired by the subcontractor as their own subcontractors but does not include entities that provide supplies only and no labor to the overall contract or project.

Objective 1 VDOL: Some Steps Taken to Address Misclassification, but Programs Not Enforcing All Penalties

A 2012 executive order[10] required VDOL to lead a multi-agency task force charged with combating the practice of employee misclassification, and stated that Vermont's laws regarding misclassification must be aggressively enforced in a coordinated, timely and consistent manner by all agencies and departments. The task force met three times subsequent to the issuance of the executive order, but the third meeting held July 15, 2015, was the first meeting in two years. Information regarding outcomes of meetings held in 2012 and 2013 was limited and required annual reports of findings were not provided to the Governor. While the task force did not meet for two years, VDOL took actions relative to its own operations that addressed some of the task force objectives, including development of an outreach campaign. It's not clear why the task force did not meet in the two years prior to July 2015, but additional required work remains, such as examining and evaluating existing misclassification enforcement by agencies and departments. Massachusetts and New York have convened tasks forces to address worker misclassification and have reported better agency cooperation, more efficient use of resources, and significant monetary recoveries. VDOL indicated that it has taken steps to schedule two additional meetings in 2015.

The executive order also specified that agencies and departments should engage in timely enforcement, but VDOL has failed to enforce unemployment insurance penalties for worker misclassification, which have been statutorily required since 2010, and some workers' compensation penalties as well. VDOL indicated that they have not enforced all misclassification penalties because the department has not established necessary rules for UI and WC to enforce these penalties. Scheduling additional meetings to address the other required task force actions may improve prevention and detection of worker misclassification.

VDOL Took Some Steps to Address Actions Required by Executive Order, but No Misclassification Task Force Meetings Occurred from 2013 to 2015

One task force charge was to develop and implement a campaign to educate and inform employers, workers, and the general public about misclassification. To meet this objective, UI plans to develop and implement

[10] Executive Order No. 08-12, [Governor's Task Force on Employee Misclassification, signed September 8, 2012].

a media campaign for education and outreach regarding worker misclassification. The purpose of the campaign is to inform and educate Vermont employers and the workforce on adverse impacts and potential sanctions for illegal actions relating to misclassification. It also has the goal of helping with prevention, detection and reporting of misclassification. The department received federal funding for education and outreach and recently contracted with a vendor to move ahead with the campaign.

The task force is comprised of nine members: the commissioners of VDOL, Financial Regulation, BGS, Tax, and Liquor Control, and the secretaries of the agencies of Administration, Transportation, Commerce, and Human Services. They were charged with a number of tasks, including identifying barriers to information sharing and recommending statutory changes when necessary. Some instances of information sharing were in place prior to the issuance of the executive order and others have developed subsequently. For example, UI and the Department of Taxes (DOT) have had a memorandum of understanding (MOU) in place since 2007 that allows for information to be shared between these departments. Specifically, two data files are shared, one that shows businesses registered at DOT but not at VDOL, and another that identifies wage reporting discrepancies between what was reported to VDOL and DOT.

Coordination also occurred with the Department of Liquor Control (DLC) and the Secretary of State's Office (SOS). Beginning in 2011, on a monthly basis, DLC sends a list of newly licensed businesses to the WC division, which reviews the list, confirms that workers' compensation insurance has been obtained, and if not, opens an investigation. In addition, since 2011 VDOL has been involved in the development of BIZ Portal with SOS and DOT. The portal is designed to offer a one-stop sign-up process integrating the requirements of multiple agencies in a single application process. For example, new businesses may use BIZ Portal to register with the SOS, DOT, and VDOL, if applicable. According to the Director of UI, phase II of the development of BIZ Portal will provide an alert notice to VDOL if an employer registers with SOS and DOT but has not completed the process with VDOL in the portal. According to the Director of the WC division, VDOL also coordinates with the Secretary of State's Office to ensure that amusement ride operators have WC insurance.

In addition to coordinating and sharing information with state entities, VDOL has an MOU with the Internal Revenue Service (IRS) to facilitate information sharing and other collaboration. Through this MOU, UI receives 1099 data and uses this information to help select businesses to audit.

The task force was also charged with working collaboratively with business and labor. In 2011, VDOL coordinated a work group, comprised of

representatives of labor, business, VDOL staff, and legislators for the purpose of establishing a common definition of an independent contractor for workers' compensation and unemployment statutes. The work group agreed to a process that would allow an individual to apply for certification as an independent contractor by a panel of peers, with approval by the commissioner of VDOL. House bill 762 was introduced in 2012 and contained a process for sole contractors to apply to VDOL for authorization to operate independently and without the benefits of workers' compensation and unemployment insurance. This bill was passed by the House, but not the Senate. Legislation was introduced during the 2015 legislative session to establish a common definition of independent contractor (H.378) and to create an authorized sole contractor program under VDOL (H.335). Both bills were referred to the committee on Commerce and Economic Development, but no further action was taken.

The task force met in 2012 and 2013, but VDOL did not have evidence to demonstrate whether task force members or designees attended the meetings and had limited information regarding the outcomes of the 2012 and 2013 meetings. The task force was required to provide an annual report of findings to the Governor, but these reports were not produced. It's not clear why VDOL did not convene the task force for two years, but the department held a task force meeting July 15, 2015 and indicated it has plans to hold two additional meetings in 2015.

Actions required of the task force remain unaddressed, including 1) an examination and evaluation of existing misclassification enforcement by agencies and departments, and 2) a coordinated review of existing law and other methods to improve monitoring and enforcement of misclassification. According to the 2015 annual report of the New York (NY) task force,[11] coordinated enforcement and data sharing between agencies allowed for sharing of resources and made their work more efficient. In particular, the NY task force conducts enforcement sweeps, which involve a coordinated visit and inspection of a worksite by members of the task force.[12] All sweep cases that identified misclassification are referred to the NY Department of Taxation and Finance for assessment of state income tax owed. Further, the

[11] New York Department of Labor, Annual Report of the Joint Enforcement Task Force on Employee Misclassification.

[12] Sweep teams include members from the Department of Labor Unemployment Insurance and Labor Standards Division, Department of Labor's Office of Special Investigations, Workers Compensation Board Bureau of Compliance, Workers Compensation Board Office of the Fraud Inspector General. Sweeps involving public work construction projects and some private construction jobs include the Bureau of Public Works.

2014 annual report of Massachusetts' task force[13] states that agencies recovered about $20 million in wage restitution, state taxes, unemployment taxes, fines, and penalties as a result of the cooperative efforts of the task force and that this represented monies above and beyond what the member agencies collected through ordinary enforcement efforts. Based on these recent reports, a coordinated evaluation by the task force of existing misclassification enforcement, existing law, and other methods to improve monitoring and enforcement of misclassification could yield positive results for preventing and detecting worker misclassification. This could have the added benefit of increasing revenues.

VDOL UI and WC Programs Not Enforcing and Collecting All Penalties

UI has had authority to impose penalties, and in some cases debarment,[14] for worker misclassification violations since 2010. With regard to WC, new penalty provisions for worker misclassification violations, including debarment, were added to statute in 2007, 2009, 2010 and 2011.[15] However, neither program has enforced the debarment penalties nor has UI enforced monetary penalties.

According to a spreadsheet maintained by the UI Field Audit Chief, potential penalties of $263,335 were reported to employers in 2014, but not assessed.[16] In reviewing WC's monetary penalties for 2012 to 2014, we found that some penalties were imposed in 2012, but the department was unable to determine whether all 2012 penalties were collected and no penalties were assessed in 2013.[17] In 2014, WC issued 25 citations with $122,210 penalties assessed.

VDOL indicated that they have not enforced all misclassification penalties because the department has not established all of the necessary rules for UI and the WC rules have not been updated since 2001. In particular, VDOL believes that UI needs an appeals process for misclassification penalties and the debarment rules need to be more specific regarding the time period for debarment. WC does not have rules to assess compliance statement penalties

[13] Commonwealth of Massachusetts, Joint Enforcement Task Force 2014 Annual Report.

[14] Debarment is a prohibition from contracting with the State or any of its subdivisions for up to three years following the date the employer was found to have misclassified.

[15] Act 57 (2007), increased penalty amounts, Act 54 (2009), introduced debarment penalties, Act 142 (2010), changed statute to include debarment penalties and increased monetary penalties, and Act 50 (2011), clarified the monetary penalty amount that may be assessed against an employer for the first seven days the employer failed to secure WC insurance.

[16] SAO did not test the reliability of this data.

[17] Appendix IV contains administrative penalties that VDOL may assess against employers for misclassification violations under unemployment insurance and workers' compensation statutes.

or to debar employers that misclassify. The statutes requiring penalties and debarment under unemployment insurance law were effective in 2010 and the legislative changes made to the workers' compensation statutes occurred between 2007 and 2011. Since that time, VDOL has not addressed the gaps in the rules that it believes exist.

In 2014, VDOL initiated the process to update WC rule 45 (penalties) but did not meet the deadlines established for the rulemaking process. The administrative rulemaking process involves a series of filings, hearings, and review, with attendant deadlines. An agency has eight months from the date of initial filing with the Office of Secretary of State to adopt a rule, unless extended by the legislative committee that approves the rule. VDOL will need to start the process again and resubmit the rules proposal.

VDOL has not only failed to enforce all required penalties, the department does not know the collection status of $16,200 in workers' compensation penalty receivables for two penalty citations issued in 2012. The department lacks a consistent record-keeping process, and WC has not established a centralized method to account for citation penalty receivables. WC left it up to the individual staff attorney that was involved in the penalty citation process to determine how to track penalty citations and collections. This resulted in a lack of record history when staff attorneys left VDOL employment, and as a result, VDOL was not able to provide evidence that these penalties were collected.

The Department of Finance and Management's best practices for accounts receivable[18] include:

- Written procedures for all accounts receivable and collection activities, which address how bills shall be prepared, how the receivables shall be recorded, how payments shall be recorded, how adjustments to receivables shall be handled, and how account delinquencies shall be followed-up on.

- Billings that are generated and sent to customers at least monthly with payment terms indicated on the bill.

No written guidance has been established for workers' compensation citation penalty receivable accounting. The staff attorney, who was new to this position in 2014, established a Microsoft Excel® spreadsheet to track the actual payments received. However, this spreadsheet was not designed to

[18] Vermont Department of Finance and Management, *Internal Control - Best Practices #4, Accounts Receivable.*.

maintain detailed employer payment history (e.g., check date, check number, etc.), and billing statements have not been generated and sent to employers.

The State's accounting system, VISION, has an accounts receivable module and billing module which can produce billing statements and provide an accounting for the penalty receivables. The SAO spoke with the VDOL Finance Director, who plans to review the use of VISION as the accounting system to record and bill workers' compensation citation penalties with his staff and the WC staff.

Objective 1 UI: Changes to Audit Selection Criteria Could Increase Detection and Unreliable Performance Data Hampers Assessment of Impact

UI field audits[19] identify worker misclassification, but improvements could increase detection. For example, UI selected 71 percent of its 2014 audits on a random basis, despite a United States Department of Labor Office of the Inspector General (U.S. DOL OIG)[20] report that found those states that used targeted audit selection criteria were more effective at detecting noncompliance with unemployment insurance tax laws than states that selected employers at random.

The UI division also had difficulty measuring performance. UI identified errors in the field audit performance data reported to the U.S. DOL for calendar year 2014, and our office found additional errors in the number of misclassified workers reported. Errors identified by UI and SAO occurred for a variety of reasons, including data entry errors, lack of supervisory verification of data input, and lack of documented procedures for compiling field audit data for the performance reports. Lacking reliable performance data, UI does not know the impact its program has had on detecting misclassification, and management has relied on flawed performance data in its decision making about the field audit program which increases the risk that incorrect decisions were made.

[19] The U.S. DOL defines a field audit as a systematic examination of an employer's books and records, using generally accepted auditing standards and procedures covering a specific time during which the employer is liable for reporting under the law, or is found to be liable as a result of the audit.

[20] U.S. Department of Labor- Office of the Inspector General Report No. 03-99-006-03-315, *Adopting Best Practices Can Improve Identification of Noncompliant Employers for State UI Field Audits*.

Increased Use of Targeted Selection Could Improve Detection

UI relies primarily on a random selection process to determine which businesses to audit, with the exception of judgmentally selecting some employers based upon 1099 data that is provided to VDOL by the Internal Revenue Service (IRS). Federal guidance[21] encourages states to utilize audit selection criteria that indicate noncompliance (e.g., targeted selection criteria).

According to UI records, approximately 87 percent of 2013 field audits were based on a random selection methodology. The remaining 13 percent of the field audits in 2013 were targeted audits based upon 1099 data UI received from the IRS. In 2014, VDOL reported that they had begun to utilize federal 1099 data to increase the number of judgmentally selected audit assignments. According to UI records, about 29 percent of the 2014 field audits were assigned using 1099 data to perform targeted audits, while the remaining 71 percent of audits assigned were still based on a random selection methodology.

Federal guidance and UI's Field Audit Manual state that random field audits should account for at least 10 percent of the field audits assigned. Neither manual indicates that the random selection process should be the primary criteria for selecting field audits. In contrast, the U.S. DOL encourages states to maintain field audit selection criteria that target employers based upon a greater potential risk of noncompliance, such as high employee turnover, sudden growth or decrease in employment, type of industry, location (geography) of employers, prior reporting history, or results of prior audits.[22]

In fact, the U.S. DOL OIG found that the states with the top performing field audit programs were those states where management focused primarily on achieving the highest results possible per audit hour by designing ways to select employers for field audit that had the highest likelihood of noncompliance, rather than simply selecting employers at random.[23]

UI's own Field Audit Manual states that audits can be generated from sources such as an employer report showing obvious errors in reported wages, a filed unemployment claim that indicates possible missing or incorrect wage reporting, and substantiated tips or correspondence from other sources.

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[21] U.S. DOL's Employment Security Manual, *Appendix E, Field Audits*.

[22] U.S. DOL's Employment Security Manual, *Appendix E, Field Audits*.

[23] U.S. Department of Labor- Office of the Inspector General Report No. 03-99-006-03-315, Adopting Best Practices Can Improve Identification of Noncompliant Employers for State UI Field Audits.

The OIG findings and UI and U.S. DOL field audit selection guidance provide a basis for increased use of targeted audit selection techniques, which could result in improved detection of noncompliance and worker misclassification in field audits.

Unreliable Performance Data Hampers Assessment of Impact of UI Enforcement Program

Field audits are a significant enforcement tool for VDOL, but the data compiled on the number of field audits conducted and misclassified workers detected by field audits is unreliable. UI identified various errors in the field audit performance data reported to the U.S. DOL during calendar year 2014. Further, SAO identified that the number of misclassified workers reported to the U.S. DOL did not match misclassification information maintained by UI's field audit division. Errors identified by UI and SAO occurred for a variety of reasons, including data entry errors, lack of supervisory verification of data input, and lack of documented procedures for compiling field audit data for the performance reports. VDOL also found that the computer program query used to pull performance information counted the same audits in multiple quarters. The extent of the impact of all of these errors has not been determined. UI has informed the U.S. DOL that there were errors with the information they provided to the U.S. DOL for 2014, and UI has requested guidance on how to report the corrections.

In addition to errors in the data, UI did not count follow ups on complaints from the public or referrals from other state entities as field audits, even though the procedures used were the same as for field audits. As a result, the output of this work is not included in field audit performance data. Lacking reliable performance data, UI division cannot assess the impact its program has had on detecting misclassification. Further, management has relied on inaccurate performance data to make decisions about the field audit program, which increases the risk that improper decisions could be made. Reliable data is necessary for UI to evaluate the performance of their field audit activity and to determine whether they are meeting program objectives and federal performance standards.

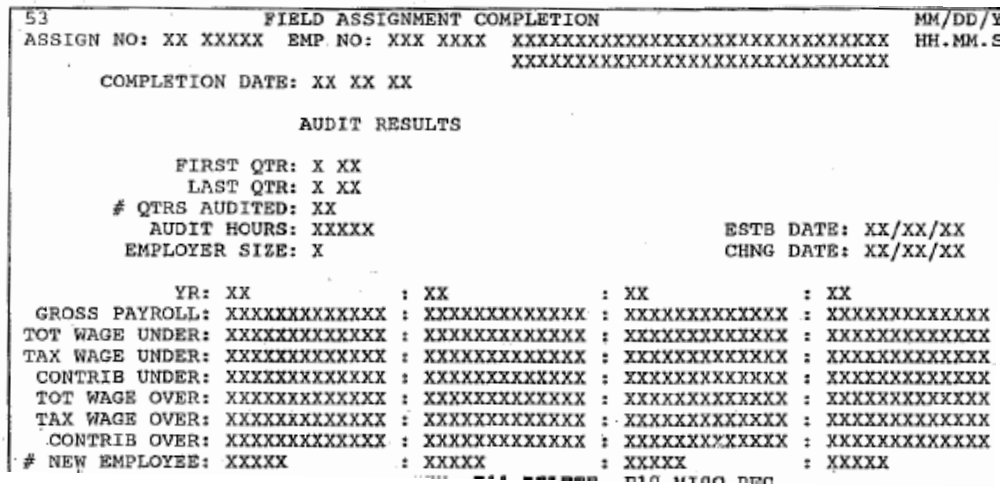
Performance Data Reporting

The U.S. DOL has established performance measures to evaluate the effectiveness of a state's field audit activity. Quarterly, UI reports basic field audit information to the U.S. DOL, such as the number of audits completed, the total wages audited by the state pre-audit and post-audit, and the number of misclassified employees identified during these audits. This information is submitted in the ETA 581 report. Both VDOL and the federal government utilize the information contained in this report for performance monitoring. U.S. DOL established a minimum level of achievement for field audits,

which is measured based upon the performance data reported via the ETA 581. In the FY2014 annual State Quality Service Plan provided to the U.S. DOL, VDOL reported revamping its audit selection strategies to focus on the effective audit measure criteria.

UI utilizes the CATS system[24] to compile field audit performance data and uses this data to monitor performance results and capture information for federal reporting. Auditors mail their audit files to the central office, and information contained in the files is then manually entered into the CATS system using the CATS 53 screen. Figure 1 shows the various fields in the CATS 53 screen that are used to input field audit performance data.[25]

Figure 1: CATS 53 Screen



```
53                FIELD ASSIGNMENT COMPLETION                          MM/DD/Y
ASSIGN NO: XX XXXXX  EMP NO: XXX XXXX  XXXXXXXXXXXXXXXXXXXXXXXXXXXXX  HH.MM.S
                                       XXXXXXXXXXXXXXXXXXXXXXXXXXXXX
      COMPLETION DATE: XX XX XX

                     AUDIT RESULTS

           FIRST QTR: X XX
            LAST QTR: X XX
       # QTRS AUDITED: XX
         AUDIT HOURS: XXXXX                          ESTB DATE: XX/XX/XX
       EMPLOYER SIZE: X                              CHNG DATE: XX/XX/XX

              YR: XX           : XX             : XX             : XX
   GROSS PAYROLL: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
TOT WAGE UNDER: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
TAX WAGE UNDER: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
  CONTRIB UNDER: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
  TOT WAGE OVER: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
  TAX WAGE OVER: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
    CONTRIB OVER: XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX : XXXXXXXXXXXXX
# NEW EMPLOYEE: XXXXX          : XXXXX          : XXXXX          : XXXXX
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Currently the number of identified misclassified employees[26] is entered into the system based upon a C35 report[27] and audit notes. Payroll data is manually entered into CATS based upon a separate audit report contained in the audit files, called the audit 53 report.

[24] CATS is the Employer Contribution Tax System.

[25] This screen is not used to establish employer liabilities. The information on this screen is for field audit performance measurement only.

[26] The "# NEW EMPLOYEE" fields are the fields in which the central office records the number of employees who were found to be misclassified during the field audit.

[27] The C35 report is a wage record analysis used to show any wage discrepancies and is not limited to only displaying misclassified employees.

Misclassification Errors

UI reported to the U.S. DOL that field audits completed in 2014 identified 1,553 misclassified employees. However, the misclassification data maintained by the UI Chief Field Auditor shows 1,339 misclassified employees identified in audits completed during calendar year 2014.[28]

The number of misclassified workers is clearly stated on two reports utilized by field auditors, a field audit questionnaire and a separate misclassification report, which only reports on misclassified workers. Both are included in the audit file that is mailed to the central office. In addition, the auditors maintain a spreadsheet to record the total number of misclassified workers identified during each assignment, which is provided to the UI Chief Field Auditor on a quarterly basis.

However, the central office does not utilize any of these audit records to input the number of misclassified employees into CATS. Rather, the central office uses the C35 report in the audit files that also includes employees who were not misclassified but were found to have wage discrepancies between the employer's payroll records and the wage records the State received from the employer. Therefore, there is a risk that employees that were not actually misclassified were included in the misclassification count.

For example, the SAO reviewed an audit record that covered two years and found that the UI auditor identified two workers who were misclassified in both years. The UI auditor also identified other employees whose wages were underreported each year in that audit record. The central office input the number of misclassified workers into their system, using the C35 report that included both the misclassified workers and the workers with underreported wages. Therefore, instead of recording two misclassified workers, the central office recorded four misclassified workers for the audit. Additionally, because the audit covered two years, the central office input four misclassified workers each year. The report run by UI to identify the number of misclassified workers found during field audits totals the number of misclassified workers entered for each year.[29] Therefore, while this field audit identified only two misclassified workers, UI reported eight misclassified workers in their report to the U.S. DOL for this audit.

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[28] The SAO did not perform procedures to validate the accuracy of this number. However, the SAO did remove duplicate information contained in the original spreadsheets.

[29] The number of misclassified workers reported in the CATS 53 screen is only for those that are identified during field audits. UI may identify misclassified workers during other assignments but because they are not field audits that information is not input into the CATS 53 screen.

As shown in Figure 1, the CATS screen does not have a single field to record the total number of misclassified employees identified during a field audit. Instead, CATS has fields to record the number of misclassified workers (# NEW EMPLOYEE field) identified each calendar year audited.

In another example, the SAO found an audit that identified a total of seven misclassified workers over a four-year period. Some workers were misclassified over multiple years while others were misclassified for a single year. When the central office input the number of misclassified workers found for each calendar year, they input seven misclassified workers for year one, seven for year two, and did not enter anything for year three or four. Therefore, this audit would have been erroneously reported to the U.S. DOL as having identified 14 misclassified instead of the actual seven misclassified workers identified.

UI has not documented procedures on how to enter the data into the CATS 53 screen and never established documented procedures for ongoing supervisory monitoring of the accuracy of data entry.

Wage Data Input Errors

As a result of a data entry review requested by the Director of UI during the course of our audit, UI identified 233 discrepancies between payroll data in CATS and the audit files for 59 field audits conducted in 2014. Table 1 summarizes what UI reported to the U.S. DOL in 2014 and the net changes UI made to various CATS 53 fields after discovering the data input errors.

Table 1: Data Entry Errors Identified by UI[30]

CATS 53 Field	Total Reported to the U.S. DOL on ETA 581	Net Changes Made By UI	Net Changes as a Percent of Total (Changes/Originally Reported)
Gross Payroll	$598,539,360	$6,933,595	1%
Total Wages Underreported	$10,670,260	$665,114	6%
Taxable Wages Underreported	$8,633,306	$1,264,741	15%
Contributions Underreported	$513,194	$40,786	8%
Total Wages Over Reported	$487,848	$101,822	21%
Taxable Wages Over Reported	$512,277	$1,009,886	197%
Contributions Over Reported	$17,099	$22,267	130%

According to UI, these errors were a result of manual data entry errors where the information input into the CATS 53 screen did not match the information in the audit 53 reports (source record for wage data in the audit file). Auditors mail in audit 53 reports that are used by the central office to input wage information into the CATS 53 screen. UI acknowledged that they did not have documented procedures on how to enter the data or a process in place to adequately monitor the manual data input, including a lack of supervisory review. According to the Employer Service Chief, she will perform supervisory reviews in the future, where she will compare the data entered in the CATS 53 screen to the data reported on the audit 53 reports.

Discrepancies between the audit files and data entered into the CATS system also occurred when the audit 53 report did not reflect the final conclusion of the audit. For example, field auditors sometimes make manual adjustments or complete supplemental schedules, and these changes were not always reflected in the audit 53 report. It appears the data entry process designed by UI did not anticipate that final audit results would be documented outside the audit 53 report. Further, UI has not established procedures to ensure that the

[30] Errors within individual audit files may have been either an understatement or overstatement of what should have been reported to the U.S. DOL. Overall the net effect for all errors in all categories was an increase in the amount that should have been reported to the U.S. DOL for that category.

audit 53 report reflects the actual final audit results. While the audit 53 report does not affect employer's liability, it does affect the reliability of performance data that is reported to the U.S. DOL and used by management to monitor the performance of the program.

Errors from Double Counting Audits

VDOL identified 19 records from 2013 audit assignments and at least 5 audit assignments from 2014 that were likely reported on more than one ETA 581 report, which would erroneously inflate performance results. Audits were being double counted in more than one ETA 581 because the extract for the report was programmed to pull data using a date field that changed anytime a change was made to the audit record in the CATS 53 screen. UI program management believed that the extract was based upon the audit completion date, which remains the same despite changes to audit records in CATS, so they were unaware of the problem until it was uncovered in the course of this audit. There may have been other audit assignments in 2014 reported on more than one ETA 581 report. However, every time an audit record is changed the field is overwritten and an audit trail is not maintained, so VDOL could not determine whether other assignments had been reported on multiple ETA 581 reports. VDOL Information Technology (IT) reported that they have written a code that will utilize the audit completion date to pull data for future ETA 581 reporting purposes.

According to the Director of IT, the IT division has created a program that captures the assignment numbers of each audit included in an ETA 581 report. This will allow VDOL to perform queries in the future to determine if an audit assignment was included in more than one ETA 581 report. Additionally, if an audit needs to have a correction or change made to it, the new program is intended to allow VDOL to accurately identify which ETA 581 report will require an amendment.

The process of loading audit results into the CATS system is highly manual. Manual processes are susceptible to error and this risk has been heightened by a lack of documented procedures, inconsistent documentation of results in the audit files, and a lack of supervisory review. UI is part of a multistate project consortium[31] established to procure a more accurate and fully integrated unemployment insurance tax and benefit system. The consortium has issued an RFP for a system that includes a module for agency staff to conduct employer audits. The RFP calls for the new system to be installed and in production in each of the consortium states no later than March 31, 2019. Therefore, changes are still needed in the near term in order to prevent

[31] The other member states in this consortium are Maryland and West Virginia.

further duplication and inaccuracies in the audit results reported to management and the federal government.

Assignments Not Counted as Audits for Federal Reporting

The Employer Security Manual, a federal guide for the UI program, establishes certain criteria for work to be considered an audit.[32] According to the UI management, assignments resulting from complaints and referrals have not been reported as field audits by UI, even if the work involved the same steps as an audit. For example, the SAO identified one assignment where UI audited two years of an employer's payroll, identified nine misclassified employees, and assessed unemployment taxes and interest against the employer. However, because UI does not categorize assignments resulting from complaints or referrals as field audits, this work was not considered an audit by the UI program and was not captured in field audit performance data. As a result, UI has possibly underreported their audit results by excluding these results.

Objective 1 WC: WC Has Limited Ability to Measure Results

According to WC records, 30 investigation cases started in 2011 have not been completed and 134 cases categorized as active are assigned to investigators no longer employed by VDOL.[33] We also found that some cases were closed due to the age of the investigations. The lack of follow through on these cases occurred because WC has not developed protocols for case reassignment and case management practices, such as standards for maximum caseloads per investigator and timely case completion. Additionally, WC uses two systems to record summary investigation case data, and the primary database has limited functionality, contains data anomalies and duplicate case information, and is missing data for a substantial number of records. The combination of these factors has hampered management's ability to monitor investigation status and ensure that all investigations are completed. Further, management's ability to measure the program's effectiveness is limited.

[32] See Appendix V for US DOL minimum requirements for field audits.

[33] We cite statistics as of January 23, 2015 from this system, but as reported elsewhere, we have concerns about the reliability of this data.

No Standards for Maximum Caseload, Timely Completion, Case Reassignment, and Prioritization

At the time of our audit, the WC Investigations' Program had only one workers' compensation investigator, along with the WC Investigations' Program Chief, performing investigations. The WC investigation database showed 73 investigations assigned to this single investigator.[34] Some of these investigations date back to the beginning of 2011. These case records had no data in the Date Investigation Complete field,[35] the Cited field,[36] or the File Closed field,[37] so it appeared all were ongoing cases. In addition, the investigator had four other cases assigned in the CATS database, previously used to record investigation case data, which had not been completed nor transferred into the WC investigation database currently used by VDOL. In addition to the 77 investigations assigned to the one investigator, there are 134 investigations categorized as active assigned to investigators no longer employed by VDOL.

The Director of the Workers' Compensation and Safety Division indicated that follow-up on complaints and referrals is prioritized by risk to the uninsured employee (e.g., a roofer has a higher risk of injury than an accountant). However, SAO identified five open investigation records[38] in the WC investigations database that contained references to an injured worker and the cases are assigned to investigators that no longer work for VDOL.

In addition, data in the WC investigations database show five cases assigned to former investigators have stop work orders (SWO)[39] that are still active.

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[34] These 73 cases include both claimant fraud and employer liability investigations. WC claimant fraud is outside the scope of this audit. The SAO only counted cases assigned to this investigator since 2011.

[35] The Date Investigation Complete field records the date that the investigator completes their casework and requests a review of their findings.

[36] The Cited field is used to record whether an employer has been cited after the investigation is completed.

[37] The File Closed field is used to record the date that the entire case file was closed.

[38] Two of these investigations involve two separate employers but were the result of the same individual's injury.

[39] These are orders by the Commissioner of VDOL to stop work until the business provides evidence that workers' compensation insurance was obtained.

Since these cases are assigned to former investigators, it appears there is no active monitoring of the status of these cases.[40]

WC has closed at least five cases due to the age of the investigations. However, according to records, 30 investigation cases started in 2011 have not been completed. The Director of the Workers' Compensation and Safety Division reported that WC plans to close all of the cases in the WC investigation database that have been active for more than three years. During this process, they will review the insurance status of each employer. If the employer does not have workers' compensation insurance, a new investigation will be opened to determine whether that employer should currently be carrying workers' compensation insurance.

These issues may have resulted from WC's failure to establish standards for the number of misclassification cases investigators are expected to conduct, the timeframe for completion of these cases, and how cases will be re-assigned due to staff changes. In addition, WC lacks a written protocol for case prioritization, and the WC investigations database does not contain a field to record prioritization. Therefore, the database cannot generate any kind of report pertaining to case priority.

OIG standards[41] for investigative organizations indicate that all investigations should be conducted in a timely manner, especially given the impact investigations have on the lives of individuals and activities of organizations. The OIG also states that case assignments should be based on resource considerations, geographical dispersion, level of experience of personnel, and current workloads. According to the OIG, investigative organizations should establish written investigative policies and procedures via a handbook, manual, directives, or similar mechanisms that are revised regularly.

Without these standards, there is a risk that investigators may have more cases assigned than they can realistically perform in a timely fashion, causing lengthier investigations and introducing the risk that cases won't be completed. Without a mechanism to convey case priority and monitor high priority cases, risk is increased that investigation cases that WC judges to have a higher priority will not be addressed in a timely fashion.

[40] Due to the unreliability of the WC investigation database, it is possible that these SWOs have been rescinded but were never recorded as rescinded.

[41] Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Investigations*, November 15, 2011.

Multiple Record-Keeping Systems

According to the WC Investigations' Program Chief, her primary source for case information is the WC investigations database, an Access® database.[42] However, some cases are not in the WC database because from July 2013 to March 2014 WC utilized the Unemployment Insurance program's CATS system to record investigation information. During that time, WC stopped recording most of their case information in the WC investigations database. Based on records in the WC investigations database and the CATS system, there are 225 active investigation cases. Of the 225 cases, 24 are in CATS. According to the WC Chief, not all active cases were transferred to the WC database because of limited resources to perform the administrative work necessary to transfer all the case data. Maintaining case data in multiple systems makes it more difficult for WC to monitor the status of all its cases and increases the risk that some investigations will not be completed.

Generally, a single record-keeping system supports an easier and more efficient reporting of case history. Furthermore, the Law Enforcement Information Technology Standards Council (LEITSC)[43] notes that one of the general requirements for records management systems (RMS) is that they are a single database.

In addition to investigation case data residing in multiple systems, WC does not have a central repository to record all complaints and referrals. The results of preliminary research performed by the WC Investigations' Program Chief of complaints from the public and referrals from other government organizations may or may not be recorded in the WC investigations database. If preliminary research of a complaint or referral results in a case assigned to an investigator, the case is recorded in the WC investigations database. However, claims that are deemed unsubstantiated are recorded in a Microsoft Excel® spreadsheet.

The Council of the Inspectors General on Integrity and Efficiency (CIGIE) and three other professional organizations[44], all promote having systems that will log each complaint, track each complaint to resolution, and allow for retrieval of all complaint data.

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[42] Access® is a Microsoft® database application for Windows®.

[43] The U.S. Department of Justice funded the creation of the LEITSC in 2002 and continues to promote the RMS standards on its website.

[44] The American Institute of Certified Public Accountants (AICPA), the Institute of Internal Auditors (IIA), and the Association of Certified Fraud Examiners (ACFE).

Lacking a single system to track the status and disposition of complaints and referrals, management has no assurance that every complaint or referral is acted upon accordingly. VDOL's UI division has designed a system to log and track complaints and referrals that will soon become fully operational. Once it is fully operational, VDOL plans to integrate WC into this system. This should provide a central repository of all complaints and referrals received by WC.

Database Shortcomings

WC uses a Microsoft Access® database as their case management system for all workers' compensation investigations.[45] However, the WC Investigations database has limited reporting functionality, contains data anomalies and duplicates, and is missing data for a substantial number of records. It is therefore limited in its usefulness as a case management system and lacks reliable data.

Limited reporting functionality

The database consists of a single table that contains 65 data fields. All users, from the investigator to the staff attorney, have access to and utilize this database. In addition, they all use the same form[46] to input data into the single table. However, while WC created fields for users to enter data into, there is no field to report the number of misclassified workers identified during an investigation,[47] and WC never created on-going report capabilities for the various users. For example, the database has not been configured to provide information such as an aging schedule of outstanding cases, length of investigations, and status of key investigative activities, such as stop-work orders. As a result, although the database contains case history information for individual investigations, with the exception of the number of misclassified workers, the database is very limited in its ability to provide information to support case management or to measure the impact of enforcement.

The Council of the Inspectors General on Integrity and Efficiency state that management should have certain information available to perform its responsibilities, measure its accomplishments, and respond to requests by

[45] Workers' compensation investigations include fraudulent workers' compensation claims and worker misclassification investigations.

[46] A form is a Microsoft Access® database object that is used for entering, displaying, or editing the data in fields.

[47] The number of misclassified workers is documented in written citations, but this information is not collected and totaled in the WC investigation database.

appropriate external customers.[48] Without the basic case management reporting functionality, WC is unable to effectively monitor case status and program performance.

Duplicate Records

The WC investigations database also contained duplicate investigation records. The SAO identified 13 sets of duplicate case entries in the WC investigation database for cases received after January 1, 2011. One set of the duplicate records resulted in a misstatement of penalties assessed. The first case record had an incorrect penalty amount recorded in the database. The second case record was a duplicate of the first record, but contained the correct penalty amount. This instance of duplicate records resulted in the WC investigation database showing $5,900 more in assessed penalties in calendar year 2014 than what the WC Division originally assessed on the citations.

Duplicate records can be attributed to three main causes. First, the WC Investigations' Program had a decentralized system for entering case assignments into the investigation database. Because both investigators and supervisory personnel could enter assignments into the database, there was a possibility that multiple personnel were entering data for the same case. They have reportedly stopped this practice and now use a centralized system where the Program Chief inputs all assignments into the database. Second, WC lacks documented procedures on how to maintain the database, including procedures on how case reassignments should be performed. Sometimes a case was input into the system as new instead of documenting the reassignment in the original case record, which resulted in duplicate cases. Lastly, the database lacks sufficient data fields to record more than one stop-work order per case. Occasionally, an employer may receive a second SWO if they continue to work without proper insurance coverage after the first SWO was issued and rescinded. However, because there are no documented procedures on how to input data into the database and because the database lacks sufficient fields to record more than one SWO, the WC Investigations' Program was inputting a duplicate case in order to record the second SWO.

Duplicate cases create unreliable data in the database resulting in inaccurate management reports. Additionally, database users may have incomplete case information because they are unaware that information for a case is stored in two separate records.

[48] Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Investigations*, dated November 15, 2011.

Missing Data, Logic Anomalies and Errors

The workers' compensation investigations database is missing data in various record fields for a substantial number of records, which would be useful for management reporting and analysis. See Table 2 for records missing useful data.

Table 2: Records Missing Useful Data

Field	# of Records without Data After 1/1/2012	Purpose	Usefulness
Source	2	Records the source of the referral or complaint.	Allows for trend and pattern analysis and follow-up with the originator if necessary.
Date Assigned	1	Date that the investigation was assigned to the investigator.	Allows for monitoring of timely case completion.
Subject of Investigation	11	Employer, claimant, etc.	Allows for trend and pattern analysis.
NAICS (for investigations of employers only)	189	North American Industry Classification System (NAICS) used by federal and state agencies to classify businesses by industry for the purpose of collecting, analyzing, and publishing statistical data.	Allows for trend and pattern analysis.
FEIN (for investigations of employers only)	31	Federal Employer Identification Number (FEIN) is used by other state programs (e.g., DOT, UI, etc.).	Allows for efficient and accurate information sharing between state entities.
Cited (Y/N) (for closed cases only)	5	Field indicates whether the investigation resulted in a citation.	Allows for pattern and trend analysis.

As shown in Table 2, the WC Investigations' Program has not recorded employer NAICS codes for a considerable number of investigations, even though that information would allow management to analyze investigation data by industry type. Without this analysis, WC is unable to determine accurately if there are specific industries with higher incidence of misclassified workers.

Furthermore, the WC investigation database contains data and logic anomalies because it lacks validation rules that restrict or inform a user when they are trying to enter information that does not meet the criteria for that field. These anomalies also affect the reliability of the data and management's ability to produce accurate and complete reports.

For example, the "File Closed" field has no rules that restrict how a user is to enter data into that field. Some records in the database contain various date formats such as 1/1/15, 1/1/2015 or 1-1-15. Other records contain text such as "yes" or "paid in full" in this field. The various ways information can be input into this field does not allow for consistent querying of this field.

In addition to a lack of format restrictions, the database has no validation rules that restrict illogical entries. The first step in any investigation is the receipt of a lead or referral for an investigation. Therefore, the date assigned should never be prior to the date received. However, the WC investigation database does not contain any validation rules that restrict a user from entering a "Date Assigned" date that was prior to a "Date Received" date. The SAO identified ten case records that had a "Date Assigned" date that was prior to the "Date Received" date. Five of these records were for cases received after 1/1/2012.

The database also contained erroneous data because data terms were not defined. For example, according to the WC Director, the field "Cash Collected" is for recording the citation amount collected, but this field was used differently by two staff attorneys. One staff attorney used the field to enter the total cash collected from employers on penalties assessed. A second attorney used the field to record the final assessment amount issued against an employer after an appeals process, even if that amount was not actually collected.[49] This inconsistency resulted in VDOL reporting to the legislature in January 2015 that about $64,000 in penalties was collected,[50] when the actual amount collected was about $26,000.

VDOL management has indicated that a request-for-proposal has been developed for a new workers' compensation information system and that it will include a case management system. The State's IT strategic plan for 2015 to 2019 indicates that VDOL is in the initiating phase of a project to

[49] During the employer appeals process for some cases, the penalty assessment amounts may change from what was assessed on the original citation.

[50] *Workers Compensation Fraud Study and Report* memorandum to the House Committee on Commerce and Economic Development; Senate Economic Development, Housing and General Affairs, January 15, 2015

update the WC system. However, VDOL did not provide evidence that this project will include an investigations case management system.

Other Matters

During the course of the audit, SAO identified an internal control weakness unrelated to the objectives for this audit that warranted being brought to the attention of VDOL management. The UI auditors attempt to collect, and often receive, unemployment insurance tax and interest payments from the employers before sending their audit files to the central office. The U.S. DOL Employment Security Manual encourages payment collection by field auditors. While this may be efficient, it also presents a fraud risk.

UI auditors have the ability to calculate unemployment insurance tax and interest owed, and then collect the monies for that tax and interest all before the State has even processed the assessment into their UI employer database. Because the UI auditor is performing all of this prior to VDOL receiving the auditor's audit file, the auditor has both a custodial role and a recording role. These are incompatible roles from an internal control perspective, and by not segregating these duties, UI invites the opportunity for fraud to go undetected. For example, a UI auditor has the ability to create two separate audit records. A record can go to the central office that shows no audit finding and a second record could be provided to the employer that shows the employer owes an unemployment insurance tax liability. The auditor could then collect the employer's payment that the central office was never anticipating.

This risk has been increased as a result of UI's practice of including the calculation of misclassification penalties in the audit files, even though VDOL has stated that UI may not enforce these penalties without additional rules. Nevertheless, UI auditors have been informing employers about the potential that they could be assessed a penalty for misclassification.[51]

There is a risk of fraud associated with this practice because the UI auditors collect unemployment insurance tax payments and interest from employers. The statement provided to employers showing potential misclassification penalties could appear to an employer as an actual penalty statement, and a UI auditor could collect payment from an employer without knowledge of central office. UI has reported that they stopped the practice of showing

[51] It is unclear at this time whether the UI auditors inform the employers verbally only or if they provide the employers with a misclassification penalty statement. While the audit files contain a misclassification penalty report, UI reported that they know that at least some of their auditors are not providing these documents to the employers.

potential misclassification penalties to employers once our office brought this risk to their attention.

Objective 2: Procedures Designed to Minimize Worker Misclassification on State Projects Were Incomplete and Not Consistently Followed

As required by Act 54 (2009) Section 32(a), BGS and AOT revised the State's contracting procedures to minimize instances of worker misclassification on state projects with costs greater than $250,000. These procedures included requiring contractors to complete a self-reporting form to identify worker misclassification violations and a subcontractor reporting form listing subcontractors and their workers' compensation insurance carriers. However, BGS and AOT did not validate the information provided by contractors on either of the forms, and they had not implemented the procedures for all projects that exceeded the threshold by fiscal year 2014. For example, BGS obtained contractor self-reporting forms only for competitively bid projects and did not obtain workers' compensation insurance information on subcontractors added subsequent to contract inception. AOT did not apply the procedures to non-construction projects such as personal service or aviation contracts. Consequently, the State has missed opportunities to detect instances of worker misclassification and has been at risk of using contractors or subcontractors that misclassify workers.

Procedures Address Act 54 Requirements, but Gaps Remain

In response to the Act 54 requirements, BGS revised several of its documents and the State's contracting procedures. It also developed forms to be completed by bidders and contractors to meet the requirements. AOT modeled its procedures and forms after those developed by BGS and incorporated them into its contracting and oversight procedures. See Table 3 for the requirements of Act 54 Section 32(a) and the forms and processes adopted by BGS and AOT.

Table 3: Act 54 (2009) Requirements and BGS/AOT Procedures

Provision	Requirement	Form	Process
Section 32 (a)(1)	Details of any of the contractor's past violations, convictions, or suspensions, particularly as related to employee misclassification. This information is to be included with the project bid.	**Self-Reporting form** – Requires a bidder to self-report any violations, convictions, suspensions and any other information related to past performance relative to classification for workers' compensation in the past 12 months[c] and to certify that the company/individual is in compliance with the requirements detailed in Act 54.	BGS obtains the self-reporting form during the bid process for contracts that are competitively bid. AOT obtains the form as part of a contractor prequalification process for construction contracts and during the bidding process for some non-construction contracts.
Section 32 (a)(2)	A list of all subcontractors[a] on the job (and their subcontractors), and the subcontractors' workers' compensation insurance carriers.	**Subcontractor Reporting form –** Requires the contractor to provide the requisite information prior to commencement of work.	BGS and AOT require the form after contract approval but prior to commencement of work.[d] AOT requires this information for all subcontractors added during the course of a project.
Section 32 (a)(3)	A process implemented by the contractor who is to produce a list of all workers each pay period and the work that was performed, including confirmation that the subcontractors carry the appropriate workers' compensation coverage for all workers at the job site. The list is to be provided to VDOL and DFR upon request.[b] This provision applies only to construction and transportation projects over $250,000.	**Attachment D**: Additional Terms and Conditions (used for either construction renovation or new construction) – Incorporates the language of Act 54 Section 32(a)(3).	BGS and AOT include attachment D in construction contracts.

[a] According to AOT's Standard Specifications for Contractors, "subcontractor" means an individual or legal entity to whom the primary contractor sublets part of the work. This provision of Act 54 includes entities hired by the subcontractor as their own subcontractor but does not include entities that provide supplies only and no labor to the overall contract or project.

[b] Amended by Act 50(2011) section 6.

[c] According to a memo from the Secretary of AOA, in the absence of specificity in Act 54, AOA elected 12 months as the timeline for a bidder to self-report information on any violations that had occurred.

[d] According to BGS's Purchasing and Contract Administration Director, subsequent to our audit fieldwork BGS planned to change its process to require the form prior to contract approval.

Although the agencies adopted some procedures to meet the requirements of Act 54, gaps were identified in the course of this audit. First, the self-reporting form specifies that bidders are required to provide information of past violations, convictions, or suspensions relative to classification for workers' compensation, but this is not consistent with the Act 54 requirement. Act 54 required contractors to provide details, at the time of the bid, of any of the contractor's past violations, convictions, or suspensions related to employee misclassification, which can include classification violations related to unemployment insurance as well. The self-reporting form is part of the request for proposal (RFP) package used to solicit bids on state projects, and the instructions contained in the RFP address self-reporting and require bidders to provide detailed information of past violations, convictions, or suspensions related to employee misclassification. However, because the self-reporting form is not consistent with the instructions, there is risk that a bidder would limit self-reporting to misclassification relative only to workers' compensation.

In addition, neither BGS nor AOT validate the accuracy of the self-reporting by bidders and neither verifies that subcontractors have the workers' compensation insurance coverage as listed on the subcontractor reporting form. The State's internal control guide for managers[52] identifies verification as a common control activity for determining the completeness, accuracy, and validity of information. Lacking processes to validate the information reported on the forms, BGS and AOT risk contracting with businesses that violated state employment laws in the previous 12 months or are currently misclassifying workers, which is the risk that Act 54 sought to minimize.

According to BGS's Purchasing and Contract Administration (PCA) director, BGS does not have the authority, expertise or manpower to investigate representations made on the forms and it is beyond the scope of BGS to do more than collect the data provided by the contractor and make it available to VDOL and the Department of Financial Regulation (DFR) upon request. The director referenced a 2012 Memorandum of Understanding (MOU) among VDOL, DFR, AOT, and BGS as the source for her explanation, indicating that the MOU only requires BGS to collect the forms. However, there is no mention in the MOU of these forms, whether for collection or validation.

AOT's contract administration group also noted that the primary contractor has the responsibility to administer the contract and to ensure that subcontractors have workers' compensation insurance. BGS indicated a

[52] "Internal Control Standards, A Guide for Managers." Department of Finance and Management, State of Vermont.

similar perspective. We agree that AOT's and BGS's standard construction contract terms specify that contractors must require subcontractors to maintain workers' compensation coverage, but this does not absolve AOT and BGS from the responsibility of verifying information on the subcontractor reporting forms.

Both BGS and AOT believe that it is VDOL's responsibility to reach out to BGS and AOT with information about entities that have had worker classification violations or lack the appropriate insurance coverage. AOT's deputy secretary stated a concern that accessing data from VDOL to timely verify information on the self-reporting form would be challenging. BGS's general counsel expressed concern over whether BGS has the authority to request the information from VDOL. Since the 2012 MOU did not address validation of the information provided in the self-reporting form and the subcontractor reporting form, and AOT and BGS believe it is VDOL's responsibility to provide this information to them, clarification and agreement among VDOL, DFR, AOT, and BGS regarding this issue is warranted.

BGS also lacked a mechanism to ensure that the subcontractor information is updated throughout a project. For example, one contract that we tested[53] had workers' compensation insurance information for six subcontractors, but seven were actually used on the job. The project manager said that because he was familiar with all of the subcontractors from their work on other BGS projects, he assumed that they carried the requisite insurance. The project manager stated that if he had been unfamiliar with a subcontractor, he would have checked BGS's online contract tracking database to see if the entity was listed as having an executed contract. If the entity was listed he would make the same assumption about the insurance.

According to the PCA director, BGS does not approve subcontractors but only retains the right to object to a proposed subcontractor if there is a reasonable objection to the entity and, as a result, the subcontractor reporting form is not obtained when subcontractors are added during the course of a project. She stated that the contractor informs the project manager when subcontractors are added but does not seek approval. Further, BGS project managers indicated that they rely on the contractors to obtain the requisite insurance information from the subcontractors and to inform the PCA.

The standard state contract attachment C includes a clause that requires contractors to obtain written approval from the State before subcontractors are added to a project. Without a mechanism to ensure that subcontractors are

[53] For BGS, we tested seven of 31 contracts with costs over $250,000 entered into in FY2014.

reported and approved throughout the life of the contract, there is risk that not all subcontractors have the requisite workers' compensation insurance and workers on a State project may not have the coverage they are entitled to by law.

BGS Did Not Follow Contracting Procedures for All Projects

The department obtained the contractor self-reporting form for six of the seven projects reviewed by our office, but did not obtain this information for the one project that was not competitively bid. Moreover, for two contracts BGS did not receive subcontractor insurance information until after the projects started.

Specifically, BGS neglected to obtain the self-reporting form for a $340,000 sole-source contract.[54] According to BGS's PCA director, the form is generally obtained as part of the bidding process. As a result, BGS does not receive this form or other analogous certification if the contract is not competitively bid. However, Act 54 made no distinction between competitively and non-competitively awarded contracts with regard to the requirement for contractors to report past violations related to employee misclassification for all projects greater than $250,000.

In addition, BGS did not receive the subcontractor reporting forms until after commencement of work for two contracts that we reviewed that utilized subcontractors. One of the contracts we tested had at least 78 different subcontractors, but the workers' compensation insurance information was not collected until 18 months after the project started. PCA required the primary contractor to submit the subcontractor reporting form subsequent to contract execution but prior to the commencement of work. Prior to our audit fieldwork, PCA reviewed its contract files and found that it was not routinely receiving the form. It then pursued obtaining the missing forms from the contractors. Its review has led to BGS re-evaluating its process to require the subcontractor reporting form prior to contract execution.

AOT Procedures Are Inconsistently Applied

AOT incorporated revisions and forms modeled on BGS's contracts process reporting into its contracting and oversight procedures for construction

[54] According to Bulletin 3.5, the state's contract procedures guide, sole source contracts are the result of negotiating with a single contractor without competitive bidding.

contracts and Maintenance Rental Agreements (MRA),[55] but it was unable to produce some of the forms on four of fourteen construction contracts and MRAs tested.

AOT did not update its procedures for non-construction contracts to incorporate the Act 54 revisions and forms, resulting in the exclusion of the required forms from all of the four personal service contracts tested and the self-reporting form from the aviation contract tested.

Construction Contracts and Maintenance Rental Agreements

AOT was unable to provide documentation that it had followed its procedures for obtaining the contractor self-reporting form on two of ten construction contracts tested. AOT generally obtains the self-reporting form as part of an annual prequalification process for contractors that desire to bid on any construction projects.

AOT's contract documents on one of the four MRAs also did not include the self-reporting form, which is submitted by contractors as part of the MRA bidding process.

Although AOT approves subcontractors and the approval process includes receiving specific documentation including a complete subcontractor reporting form, it did not obtain workers' compensation insurance information for two subcontracts on one of the contracts we tested. Moreover, the form listing all of the subcontractors was received five months past the start date of the contract. As AOT has documented procedures that specify when and what type of information is required to be collected, this appears to have been an oversight for this project. Once we brought it to the attention of the Resident Engineer,[56] she obtained current insurance information on the subcontractor. However, additional training for employees to ensure the procedures are followed may mitigate instances of failing to obtain information as required.

[55] MRAs are annual contracts to accomplish scheduled roadway and bridge preventive maintenance, preservation, and repair projects. The instrument is a non-determinate location/non-determinate quantity type contract. In general, contractors provide rates for various locations throughout the state where they are interested in working. Once a work project is developed, contractor selection is then based on the lowest rates, experience, and availability of contractors for the particular location.

[56] A Resident Engineer is a duly authorized representative of the agency who is responsible for engineering supervision of one or more specific projects.

Non-Construction Contracts

AOT did not collect information required by Act 54 (2009) for any of the four personal service contracts tested and did not obtain all required information for the aviation contract tested.

According to Contract Administration, AOT does not require personal service contractors to report workers' classification violations or to provide information about subcontractor's workers' compensation insurance, even though these requirements are for all state projects greater than $250,000.

In response to the requirement that contractors implement a payroll process that includes confirmation that all workers at the job site are covered by appropriate workers' compensation insurance, AOT pointed to its contracting procedures, which include a standard provision to be included in its contracts requiring the prime contractor to verify that insurance coverages are met for its subcontractors and that a list of payments to subcontractors must be submitted to AOT monthly. Each of the four personal service contracts tested included this provision. However, the form provided by AOT for contractors to submit subcontractor payment data did not address the workers' compensation insurance coverage.

Based on an AOT list of contracts over $250,000 active in fiscal year 2014, personal service contracts comprised more than a third. According to AOT's Contract Administration group, personal service contracts often do not use subcontractors, as the nature of the work often relies heavily upon the technical expertise of contracting individuals. However, one of the four personal service contracts tested by our office used five subcontractors, and no information was collected about whether they carried workers' compensation insurance.

AOT uses procedures for its non-construction contracts[57] that were last updated in December 2008, preceding Act 54.[58] According to AOT's Audit Chief, the document is expected to be fully reviewed and updated by Contract Administration in the near future.

By omitting the requisite forms and requirements from its procedures for contracting for personal services, AOT is missing an opportunity to prevent potential worker misclassification on state projects.

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[57] "Procedures for Selecting Contractors And Specifications For Contractor Services, Including Customary State Contract Provisions", revised December 29, 2008

[58] In 2011, four additional clauses were added that are unrelated to workers' compensation.

The aviation contract that we tested contained a general provision requiring the prime contractor to have payroll records available. The provision did not contain language that required confirmation that subcontractors have the appropriate workers' compensation coverage for all workers at the job site.

According to the assistant director of Policy, Planning and Intermodal Development, AOT should have received the self-reporting form as part of the bid process for the aviation contract. However, AOT was unable to produce a copy of the certification.

The State's internal control guidance lists documentation as a tool to 1) help identify, prevent or reduce risk and, 2) provide a history that shows justification for subsequent actions and decisions. Without adequate documentation, it is difficult to determine if AOT complied with statute or followed its own procedures.

Conclusions

Recent actions taken by VDOL include some that were required of a task force established by executive order in 2012, such as developing an education and outreach campaign regarding worker misclassification. Although the department was charged with leading the task force, it did not convene any meetings from June 2013 to July 2015. Further, the 2012 executive order specified that agencies and departments should engage in timely enforcement, but VDOL has failed to enforce unemployment insurance penalties for worker misclassification, which have been statutorily required since 2010, and some workers' compensation penalties as well.

Although VDOL has taken some actions related to the task force requirements, its UI division lacks reliable performance data, and the WC division's primary system for recording summary investigation case data has limited functionality and contains data anomalies and duplicate case information. These issues have limited VDOL's ability to measure the impact of the divisions' efforts to detect and address misclassification and resulted in management having to rely on flawed data in its decision making.

UI's calendar year 2014 field audit performance data had multiple errors. This data was flawed as a result of data entry errors, a lack of supervisory review of the data input, and no documented procedures for compiling the field audit data. WC uses two systems to record summary investigation case data, and the primary database has limited functionality, contains data anomalies and duplicate case information, and is missing data for a substantial number of records. These problems occurred for a variety of reasons, including a lack of documented procedures for entering data in the

system. According to WC records, more than half of the investigation cases that were open as of January 2015 were assigned to investigators no longer employed by WC. The lack of follow through on these cases occurred because WC has not developed protocols for case reassignment and case management practices, such as standards for maximum caseloads per investigator and timely case completion.

Continued meetings of the task force to address the other required actions could improve prevention and detection of worker misclassification. Addressing UI's and WC's data reliability issues will enable VDOL to assess the impact these divisions are having on detecting worker misclassification.

BGS and AOT are missing opportunities to detect and prevent worker misclassification. Although both organizations developed procedures and forms designed to meet the requirements of Act 54 (2009), gaps remain, such as the lack of a process to validate information collected from the State's contractors. Additionally, neither agency consistently applied the procedures they had developed to all of their contracts. Consequently, BGS and AOT risk contracting with businesses that violated state employment laws in the previous 12 months or are currently misclassifying workers, leaving workers on state projects without the coverage they are entitled to by law.

Recommendations

We recommend that the Commissioner of Labor direct VDOL staff to:

Table 4: Recommendations and Related Issues

Recommendation	Report Page	Issue
1. Schedule Misclassification Task Force meetings and ensure that all of the required actions are addressed.	12, 14	VDOL did not convene the Misclassification Task Force for two years from 2013 and 2015.
2. Expeditiously update the unemployment insurance rules related to misclassification to cover all penalties allowable by statute.	15-16	VDOL has failed to enforce unemployment insurance penalties for worker misclassification that have been required by statute since 2010.
3. Expeditiously update workers' compensation rules related to misclassification to cover all penalties allowable by statute.	15-16	VDOL has failed to enforce workers' compensation penalties related to compliance statement violations and has not been debarring employers that misclassify.
4. Implement the use of the billing and accounts receivable modules in VISION for WC penalty receivables.	16-17	VDOL lacks a consistent and centralized record-keeping process for penalty receivables that can provide detailed payment history for WC citation penalties.

Recommendation	Report Page	Issue
5. Increase the percentage of UI audits that are conducted based upon targeted audit selection criteria.	17-19	The majority of UI's audits are randomly selected, whereas, according to the U.S. DOL OIG, states that use targeted audit selection criteria rather than simply selecting employers at random were the most effective at detecting noncompliance with unemployment insurance tax laws.
6. Develop written procedures on how UI field audit performance data should be entered into the CATS 53 screen.	21-24	UI has significant data entry errors in the CATS 53 screen and does not have documented procedures on how to enter data into the CATS 53 screen, which has led to inaccurate performance data.
7. Expeditiously implement documented supervisory review of the manual data entry of UI performance audit results into CATS.	21-24	Lack of supervisory reviews of the data entry into the CATS 53 screen contributed to the inaccuracies of the data.
8. Revise the UI audit 53 report or develop another mechanism to reflect the final audit results that are to be manually entered into CATS.	22-24	The audit 53 report, which is used to enter data in the CATS 53 screen, did not always reflect final audit results when auditors made manual changes or submitted supplemental schedules.
9. Categorize and report the results of UI assignments based upon the nature of the work performed, not the source of the assignment. Specifically, if the procedures performed as a result of follow up on complaints and referrals are equivalent to the procedures established for audits in the federal guidance, categorize this work as an audit assignment.	25	Auditor assignments resulting from complaints or referrals have not been considered field audits. The results of those assignments have not been captured in the field audit performance data even when it appears the auditors performed the work that is involved in a field audit.
10. Develop standards for WC case management that include caseload standards for investigators, timeliness of case completion and protocols for case reassignment.	26-27	Some open investigations date back to 2011, and there are many open investigations that are assigned to former investigators that no longer work for VDOL.
11. Ensure that all active cases are recorded in the WC investigations database, review the accuracy of the case data and make corrections as needed.	28	There are 24 open investigations in a database that is no longer used by WC and were never transferred into the current investigation database used by WC.
12. Ensure WC utilizes the complaint and referral log system developed by UI.	28	WC does not have a central repository to record all complaints and referrals.
13. Develop reporting functions for the WC database, including an aging schedule of outstanding cases, length of investigations, and status of key investigation activities.	29-30	WC never created on-going report capabilities in the investigation database that they utilize as their case management system.

Recommendation	Report Page	Issue
14. Develop a data dictionary or other document that defines each data field for consistent data entry in all fields in the WC investigations database.	30-33	The WC investigation database contained errors because users did not have instructions on the specific information that should be entered into each field.
15. Define which fields should be completed and develop a process to ensure that all required fields contain the requisite data.	31-32	The WC investigations database is missing data in various record fields for a substantial number of records, which would be useful for management reporting and analysis.
16. Implement validation rules and other functions in the WC database that allow for standardized data entry.	31-32	The WC investigation database does not contain any validation rules, which facilitate the input of data in a consistent format, or other functions that restrict illogical entries.
17. Add fields for case assignment priority, issuance of multiple stop-work orders, and number of misclassified workers identified.	30	The database contained duplicate case records because it did not allow users to input multiple SWOs for a single case file and does not allow users to input case priority and the number of misclassified workers identified during an investigation.

We recommend that the Commissioner of Buildings and General Services direct the Director of Purchasing and Contracting to:

Table 5: Recommendations and Related Issues

Recommendation	Report Page	Issue
1. Amend the self-reporting form to require bidders to provide information regarding any of the contractor's past violations, convictions, or suspensions related to employee misclassification.	36	The self-reporting form specifies that bidders are required to provide information of past violations, convictions, or suspensions relative to classification for workers' compensation, but this is not consistent with the Act 54 requirement. Act 54 required contractors to provide details, at the time of the bid, of any of the contractor's past violations, convictions, or suspensions related to employee misclassification, which can include employee classification violations related to unemployment insurance as well.
2. Work with VDOL, DFR, and AOT to clarify and document each organization's role with regard to verification of information reported in the self-reporting and subcontractor reporting forms.	36	BGS does not verify information on the self-reporting form related to worker's classification violations or the information on the subcontractor reporting form.
3. Modify procedures to ensure the subcontractors' workers' compensation insurance information is obtained during the course of the project for those subcontractors added subsequent to contract execution.	37	BGS's procedures do not include a mechanism that would ensure it obtains the requisite insurance information before the subcontractor begins work.
4. Utilize the procedures designed to meet the requirements of Act 54 Section 32(a) (1)-(3) for projects that are not competitively bid.	38	BGS does not obtain the self-reporting form from contractors with sole-sourced contracts.
5. Ensure that all requisite documentation is obtained on a timely basis.	38	BGS did not receive the subcontractor reporting form until after commencement of work for two contracts reviewed by SAO that utilized subcontractors.

We recommend that the Secretary of the Agency of Transportation direct staff to:

Table 6: Recommendations and Related Issues

Recommendation	Report Page	Issue
1. Amend the self-reporting form to require bidders to provide information regarding any of the contractor's past violations, convictions, or suspensions related to employee misclassification.	36	The self-reporting form specifies that bidders are required to provide information of past violations, convictions, or suspensions relative to classification for workers' compensation, but this is not consistent with the Act 54 requirement. Act 54 required contractors to provide details, at the time of the bid, of any of the contractor's past violations, convictions, or suspensions related to employee misclassification, which can include employee classification violations related to unemployment insurance as well.
2. Work with VDOL, DFR, and BGS to clarify and document each organization's role with regard to verification of information reported in the self-reporting and subcontractor reporting forms.	36	AOT does not verify information on the self-reporting form related to worker's classification violations or the information on the subcontractor reporting form.
3. Provide additional training for employees to ensure the procedures are followed.	39	AOT was unable to provide documentation that it had followed its procedures for obtaining a self-reporting form on three of fourteen construction contracts and Maintenance Rental agreements reviewed. Without adequate documentation, it is difficult to determine if AOT complied with statute or followed its own procedures.
4. Update procedures for non-construction contracts to incorporate the Act 54 revisions and forms.	40	AOT excluded required forms for all of the four personal service contracts tested and some forms for the aviation contract tested. AOT has not updated its procedures for non-construction contracts to incorporate the Act 54 revisions and forms, thereby missing opportunities to detect instances of worker misclassification.

Management's Comments

The Commissioner of VDOL provided written comments on a draft of this report on August 6, 2015. The comments are reprinted in Appendix VI of this report along with our evaluation. The Commissioner of BGS provided written comments on a draft of this report on August 6, 2015, which is reprinted in Appendix VII of this report. The Director of Finance and Administration for AOT provided written comments on a draft of this report on August 4, 2015, which is reprinted in Appendix VIII of this report.

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In accordance with 32 V.S.A. §163, we are also providing copies of this report to the commissioner of the Department of Finance and Management and the Department of Libraries. In addition, the report will be made available at no charge on the state auditor's website, http://auditor.vermont.gov/.

Appendix I
Scope and Methodology

To answer the first objective—to assess the actions that the Vermont Department of Labor (VDOL) has taken to detect and address possible worker misclassification, including the extent that the VDOL collaborates internally as well as externally with other state and federal agencies—we gained an understanding of the authority and responsibility of VDOL with regard to worker misclassification, in particular as it relates to identification and enforcement of misclassification violations through the department's UI and WC programs. Specifically, we reviewed 21V.S.A Chapters 9 and 17, Act 54 (2009), Act 124 (2010), Act 142 (2010), Act 50 (2011), Executive Order 08-12 (*Governor's Task Force on Employee Misclassification*), 26 U.S.C. Chapter 23, and other various guidance such as U.S. DOL and VDOL manuals pertaining to UI field audits and workers' compensation investigations.

We reviewed VDOL's 2015 executive budget document, 5 year strategic plan, proposed legislation, and interviewed VDOL officials regarding the status of the actions required of the Governor's Task Force on Employee Misclassification in order to review the extent of VDOL's collaboration with state and federal entities. We also reviewed the 2009 final report of the Workers' Compensation Employee Classification, Coding, and Fraud Enforcement Task Force.

We reviewed GAO and Inspector General's reports pertaining to worker misclassification to gain an understanding of the issues related to worker misclassification and reviewed reports from worker misclassification task forces in Massachusetts and New York to gain an understanding of the benefits other states were reporting from having operational worker misclassification task forces.

We interviewed VDOL officials to gain an understanding of their processes to detect and address worker misclassification. We obtained UI field audit data from the CATS system for calendar years 2013 and 2014. While performing data reliability testing of the 2014 CATS data for UI field audits, UI revealed to us that they had recently changed a significant amount of performance data in 2014 because of numerous data entry errors they had identified. Because the performance data was already determined to be unreliable, we discontinued the data reliability testing and reported on the lack of data reliability.

We obtained a copy of the WC investigations database and reviewed the data in the WC investigations database for cases that were received from January 2011 to January 2015. Based on our review of the database, we concluded that it had limited reporting functionality, contained data anomalies and duplicates, and was missing data for a substantial number of records. In the

report, we indicate that the data is not reliable. We also reviewed the data in CATS for WC investigation cases from 2013 to 2014, which is the period the WC utilized CATS as their case management program.

We also obtained and reviewed copies of the 25 penalty citations the WC program issued in 2014 and compared the citations amounts to what was listed in the WC investigation database. We also reviewed the WC penalty amounts received by VDOL in from July 2014 to January 2015 with the VDOL finance staff.

To answer the second objective—to assess whether BGS and AOT have implemented required competitive bidding and contract oversight procedures designed to minimize worker misclassification—we reviewed 2009 Act 54 Section 32(a) and its subsequent update, state contracting bulletin 3.5 and addendum, and a 2012 Memorandum of Understanding among BGS, AOT, VDOL and DFR related to 2009 Act 54.

We obtained an interpretation from the Attorney General as to whether the requirements of 2009 Act 54 Section 32(a) are limited solely to construction and transportation projects.

We interviewed officials at AOA, BGS and AOT to gain an understanding of their competitive bidding and contracting procedures and to identify the agencies' understanding of their responsibilities related to 2009 Act 54 Section 32(a). We reviewed BGS and AOT competitive bidding and contracting policies and procedures.

We assessed the procedures implemented by the agencies to determine if the procedures satisfied the criteria outlined in Act 54.

We obtained lists from BGS and AOT of projects over $250,000 active in FY2014 that were initiated subsequent to Act 54. From each of the lists, we judgmentally selected a sample of contracts for testing to assess if BGS's and AOT's monitoring procedures related to Act 54 Section 32(a) were in place and were followed. Contracts were chosen for testing using parameters such as project type, regional distribution, project start date, and contractor. We reviewed nineteen AOT contracts and seven BGS contracts.

Tests of the sampled contracts included whether each of the agencies:

- Obtained a signed bidder self-reporting form as part of the bidding process (or as part of the prequalification process for AOT's construction contracts);

- Verified that the primary contractor was not on the state's debarment list;

- Obtained an insurance certificate for the primary contractor that included workers' compensation coverage throughout the life of the contract;

- Obtained a signed subcontractor reporting form from the primary contractor that included the name of the workers' compensation insurance carrier for the subcontractor; and

- Included terms in each contract requiring the primary contractor to have a payroll process where it collects a daily census of workers on the job site and confirms that each subcontractor carries the appropriate workers' compensation coverage for all workers on site.

We performed our audit work between October 2014 and July 2015 at VDOL, AOT, and BGS offices in Montpelier. We conducted this performance audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II
Abbreviations

ACFE	Association of Certified Fraud Examiners
AICPA	American Institute of Certified Public Accountants
AOA	Agency of Administration
AOT	Agency of Transportation
BGS	Department of Buildings and General Services
CIGIE	Council of the Inspectors General on Integrity and Efficiency
DFR	Department of Financial Regulation
DOT	Department of Taxes
DLC	Department of Liquor Control
FEIN	Federal Employee Identification Number
IIA	Institute of Internal Auditors
IRS	Internal Revenue Service
IT	Information technology
LEITSC	Law Enforcement Information Technology Standards Council
MOU	Memorandum of Understanding
MRA	Maintenance rental agreement
NAICS	North American Industry Classification System
NY	New York
OIG	Office of the Inspector General
PCA	Purchasing and Contract Administration
RFP	Request for proposal
RMS	Records Management System
SAO	State Auditor's Office
SOS	Secretary of State
SWO	Stop-work order
UI	Unemployment insurance
U.S. DOL	United States Department of Labor
VDOL	Vermont Department of Labor
WC	Workers' compensation

Appendix III
Effect of Misclassification on Employees and the Financial Advantages to Employers that Misclassify

The following tables use a hypothetical worker with an annual income of $44,000 to illustrate the tax implications for a misclassified worker and the financial advantage an employer can realize by misclassifying that worker.

Table 7: Tax Effects on a Misclassified Worker

	Worker classified as an employee		Worker misclassified as an independent contractor	
Tax	**Worker's general responsibility**	**Tax amount paid by worker**	**Worker's general responsibility**	**Tax amount paid by worker**
Social security tax[a]	Pays one half of the social security tax and the employer pays the other half	$2,728	Pays the entire amount (employer and employee share) of social security tax	$5,456
Medicare tax[b]	Pays one half of the Medicare tax and the employer pays the other half	$638	Pays the entire amount (employer and employee share) of Medicare tax	$1,276
Total tax cost to the worker		**$3,366**		**$6,732**

[a] The social security tax rate is 12.4%. In an employer/employee relationship, the employer pays 6.2% and the employee pays 6.2%. An independent contractor pays the full 12.4%.

b The Medicare tax rate is 2.9%. In an employer/employee relationship, the employer pays 1.45% and the employee pays 1.45%. An independent contractor pays the full 2.9%.

Appendix III
Effect of Misclassification on Employees and the Financial Advantages to Employers that Misclassify

Table 8: Financial Advantage to the Employer the Misclassifies

Federal Taxes, State Taxes, and Workers' Compensation Insurance	Cost to an employer that properly classifies a worker with an annual wage of $44,000	Cost to an employer when they misclassify a worker as an independent contractor
Social Security	$2,728	$0
Medicare	$638	$0
Federal Unemployment Tax	$42[a]	$0
State Unemployment Tax	$1,344[b]	$0
Workers' Compensation Insurance	$1,874[c]	$0
Total cost per year	**$6,626**	**$0**

[a] An employer only pays Federal Unemployment Tax Act (FUTA) on the first $7,000 of an employee's wages. This figure assumes that the employer receives a 5.4% FUTA credit reduction and therefore results in a 0.6% net FUTA tax rate to the employer (7,000 x .006).

[b] In 2014, an employer only paid State Unemployment Tax Act (SUTA) on the first $16,000 of an employee's wages. SUTA tax rates vary based upon an employer's experience rating. This example used a tax rate of 8.4% ($16,000 x .084), which was the maximum tax rate in effect during 2014. The minimum SUTA an employer would pay in 2014 is $208 (16,000 x .013).

[c] DFR reports that the average net cost of workers' compensation insurance in manufacturing classes in Vermont was 4.26% of payroll in 2001. The SAO multiplied $44,000 by 4.26%. This example is for illustrative purposes only and should not be construed as the exact costs for businesses as actual costs vary widely.

Appendix IV
UI & WC Penalties Related to Misclassification

21 V.S.A. Chapter 17 authorizes the following unemployment insurance penalties for violations related to misclassification:

- A penalty amount up to $5,000 for each improperly classified employee.
- Debarment from contracting, directly or indirectly, with the State or any of its subdivisions for a period of up to three years following the date the employer was found to have failed to properly classify, as determined by the Commissioner of VDOL in consultation with the Commissioner of Buildings and General Services or the Secretary of Transportation, as appropriate.

21 V.S.A. Chapter 9 authorizes the following workers' compensation penalties for violations related to misclassification:

- An administrative penalty of up to $5,000 for each week that an employer failed to provide an accurate compliance statement after the Commissioner requested the employer to complete and return the compliance statement form.
- An order to stop work by the Commissioner of VDOL until workers' compensation insurance has been secured.
- A daily administrative penalty of $100 for the first seven days an employer misclassified and $150 penalty thereafter for a maximum of penalty amount of $5,000.
- A daily administrative penalty of not more than $250 for each day that an employer fails to secure workers' compensation insurance after receiving an order to obtain workers' compensation insurance.
- A daily administrative penalty of not more than $250 for each worker for every day that the employer went without workers' compensation insurance.
- Debarment from bidding or performing on any contracts with the State, either directly or indirectly, for a period of up to three years.
- A civil penalty of not more than $5,000 for the first offense and not more than $10,000 for subsequent offenses, or a criminal fine of not more than $10,000 and/or imprisonment of not more than 180 days for an employer that violates a stop-work order.
- An administrative penalty of not more than $20,000 for an employer who willfully makes a false statement or representation.

Appendix V
Minimum Criteria of a UI Field Audit

Per the U.S. DOL Employment Security Manual, a field audit is a systematic examination of a subject employer's books and records, using generally accepted auditing standards and procedures, covering a specified period of time during which the employer is liable for reporting under the law.

A field audit must meet the following minimum requirements to be defined as a field audit:

1. Generally cover a minimum four calendar quarters.

2. Verify the business entity as a sole proprietor, partnership, corporation, joint venture, or other.

3. Document records examined and evidence obtained in tests used to verify payroll procedure, accuracy, and completeness.

4. Document records examined and the evidence obtained in the search for misclassified workers and payments.

5. Closeout conference with the employer or a designated representative. If closeout not possible, explain in report.

6. Include a written report stating all facts contributing to or supporting final determination.

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In some cases, VDOL's comments were inconsistent or in conflict with our findings and did not address most of the recommendations. SAO requested clarification and additional evidence to support the department's comments. In one instance, SAO corrected the report. For others, SAO provided clarification, but these clarifications did not change the report findings and conclusions. Because of the number of VDOL disagreements, we incorporated our evaluation within the reprint of VDOL's comments. SAO comments are within highlighted boxes and are labeled "SAO Comment."

VERMONT

VERMONT DEPARTMENT OF LABOR

Memorandum

To: State Auditor Doug Hoffer

From: Commissioner Anne M. Noonan

Re: Report No. 15-07: Worker Misclassification

Date: August 4, 2015

Thank you for the opportunity for the Vermont Department of Labor to comment on the SAO's report No.15-07, Worker Misclassification. Our comments will track by page number the findings and recommendations in the report to enable the SAO staff and other interested stakeholders to follow our response. The comments we offer throughout this Management Response section are also intended as a response to the SAO Conclusion, page 42.

Page 3: Objective Finding 1:

In 2012, Governor Shumlin signed Executive Order 08-12 on September 8, 2012 creating an interagency task force to curtail misclassification of workers in the State of Vermont. The Task Force is comprised of the Secretary of Administration, Commissioner of Labor, Commissioner of Financial Regulation, Commissioner of Taxes, Commissioner of Buildings and General Services, Secretary of Transportation, Secretary of Human Services, Secretary of Commerce, and Commissioner of Liquor Control. The Commissioner of Labor was assigned the role of chair and the Department tasked with administrative support for the group.

The SAO Report states, in multiple sections throughout that *"VDOL did not schedule any task force meetings prior to July 2015"*. This is incorrect. The EO Task Force met on November 28, 2012, June 27, 2013 and July 15, 2015. In addition, during the timeframe of late 2012 to current date, there have been many meetings with key stakeholders from the employer and labor community to continue the cooperative efforts to find common ground on the issue of misclassification and potential revisions to Vermont's statutory language. The participants at these meetings were frequently the same individuals who helped to craft H.762, introduced in the 2012 legislative session as a "joint labor-management initiative" to address misclassification, (which passed the Vermont House unanimously on a roll-call vote, but later failed in the Senate in the final days of the session due to an unrelated amendment being added to the bill).

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These misclassification work-group meetings have included representatives from Associated General Contractors, Associated Industries of Vermont, Vermont Insurance Agents Association, Chamber of Commerce, Lake Champlain Regional Chamber of Commerce, Vermont Homebuilders Association, Vermont AFL-CIO, Vermont Building Trades (IBEW, Carpenters, Plumbers and Pipefitters), Vermont Teamsters, Working Vermont, , Downs Rachlin Martin PLLC, MMR LLC, individual Vermonters who work as independent contractors, and business owners who have expressed an interest in this issue.

The work-group continues to participate in work and meetings on the issue of misclassification, including recently serving as focus groups for the Misclassification Outreach and Education Campaign that VDOL is working on through a United States Department of Labor grant.

SAO Comment 1

Subsequent to commenting on the draft report, the VDOL Commissioner provided handwritten notes of a task force meeting on November 28, 2012 and an agenda for a June 27, 2013 meeting. SAO updated the report to reflect that according to the Commissioner, two meetings occurred prior to 2015, but that information available regarding the 2012 and 2013 meetings does not indicate attendees, outcomes or plans for follow-up subsequent to these meetings.

VDOL's response implies that SAO did not report VDOL's activities related to the actions required of the task force. Although VDOL provided no evidence during the course of the audit that the task force was actively addressing the objectives established in the executive order, in our draft report we indicated that VDOL had addressed some of these objectives in the course of its operations. Specifically, on pages 12 – 14 of the draft report provided to VDOL for comment on July 17, 2015, we noted that VDOL was addressing some the required task force actions and provided examples, such as UI's plans to develop and implement a campaign for education and outreach regarding worker misclassification and VDOL's efforts to work collaboratively with business and labor on worker misclassification issues. Although the evidence provided by VDOL regarding its work in these areas did not show that the task force was involved, we reported that VDOL's activities showed that progress had been made on some of the actions required by the executive order.

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Page 3: Objective Finding 1:

The SAO report states that *"VDOL indicated that they have not enforced all misclassification penalties because the department has not established the rules for UI and WC to enforce the penalties."*

While this statement is correct, the report does not include the explanation provided by VDOL for this issue. In enforcing the provisions for any administrative penalty, the person or entity penalized must have a clear and formal avenue for appeal and redress. While the statutes give the Department the authority to issue penalties and debar employers from contracting with the State, the Department has not completed rule-making with regard to the Workers' Compensation penalty and debarment process. The Administrative Procedures Act 3 VSA § 800 requires agencies to "maximize the involvement of the public in the development of rules", and to do so in a manner that is consistent and inclusive, i.e. not adopt a policy or procedure…"so as to supplant or avoid the adoption of rules".

Penalty and debarment provisions contained in the Employment Security Board Rules, as amended in 2011 do not contain sufficient guidance on the penalty and debarment appeal process. VDOL had begun penalty issuance, but internal legal advice had warned that the Department did not have a properly vetted appeals procedure, specifically, that the appeals process would need to be incorporated into UI Employment Security Board Rules and Workers' Compensation Rules. The Employment Security Board Rules, as currently written, give insufficient guidance as to the proper appeal process from a misclassification penalty and/or debarment period, and how any such appeal process would relate to an appeal from any associated unemployment assessment or administrative determination as to the amount of contributions owed, or the employer's proper contribution rate. The Vermont Supreme Court has previously cautioned the Vermont Department of Labor about imposing discretionary monetary penalties authorized by statute without first adopting, through administrative rule, sufficient guidelines for the issuance of such penalties. See Workers' Compensation Division v. Hogdon, 171 Vt. 526 (2000), and Butler v. Huttig Bldg. Products, 2003 VT 48. The Department believes that additional regulatory guidance is needed, and is currently drafting amendments to both the Workers' Compensation and Employment Security Board Rules.

SAO Comment 2

Page 15 of the draft report provided to management for comment on July 17, 2015 included the explanation VDOL provided during the course of the audit. Specifically, that VDOL believed that UI needed an appeals process for misclassification penalties and the debarment rules needed to be more specific regarding the time period for debarment. Regarding WC penalties, the same paragraph explained that WC did not have the rules to assess compliance statement penalties or to debar employers that misclassify. In the following paragraph, SAO explained that WC had initiated the process to update WC rule 45 (penalties) but had not met the deadlines established for the rulemaking process and provided a brief overview of the rulemaking process within that paragraph.

In its management comments to the draft, VDOL provided more detail as to why the department believes it needs additional rules to enforce penalties allowable by statute. However, the most salient fact remains that the department has failed to establish the rules it believes are needed for more than five years for the UI and WC programs. Our recommendation remains the same as presented in the draft report provided to management on July 17, 2015; VDOL should expeditiously update the unemployment insurance and workers' compensation rules related to misclassification to cover all penalties allowable by statute.

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The SAO report might leave the impression that VDOL was inattentive to the issue of misclassification. This would be grossly unfair and incorrect. VDOL has been enforcing provisions of 21 VSA Chapters 9 and 17 relating to misclassification, specifically,

(1) Conducting investigations that regularly led to identifying employers who were not properly insuring workers under Workers Compensation, requiring the employer to secure and prove coverage, and, in the event that an injury had occurred, requiring them to cover the medical costs and wage replacement. In addition, since the enactment of the statute, Stop Work Orders have been regularly issued to employers who attempted to continue operations without proper coverage.

(2) Conducting investigations that regularly led to identifying employers who were not properly covering employees for Unemployment Insurance, and requiring the employer to pay monies owed/additional contributions to the UI Trust Fund retroactively, along with interest.

SAO Comment 3

Throughout the draft report provided to management, we report actions VDOL has taken to detect and address worker misclassification, but we also note that improvements are needed. For example, SAO indicated that UI field audits detect worker misclassification, but that changing the criteria used to select employers to audit may improve detection and that unreliable performance data hampers the assessment of the impact of UI's enforcement program.

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Objective 1 Finding – UI, page 4

The SAO report draws the conclusion that, due to data errors, *"...management has relied on flawed data in its decision making"*. While VDOL recognizes the need for corrective action relating to data and data-systems, there is no evidence cited by SAO to support their conclusion, or that any decision-making by the Department was negatively impacted by data errors.

SAO Comment 4

To conform the statement on page 4 to the language we used on page 19 of the draft report, we amended the language to "management has relied on inaccurate performance data to make decisions about the field audit program." However, we disagree with VDOL's statement that we provided no evidence to support our conclusion. On page 19 of the draft report, we noted that the U.S. DOL established performance measures to evaluate the effectiveness of a state's field audit activity; field audit performance data submitted by VDOL via the ETA 581 report is used to calculate U.S. DOL's performance measures; and both VDOL and the federal government use the information contained in the ETA 581 for performance monitoring. Pages 20 to 24 of the draft report detail various errors in data reported to the U.S. DOL in the ETA 581. To clarify how this performance data is used, SAO added the following description to the final report, "U.S. DOL has established a minimum level of achievement for field audits which is measured based upon the performance data reported via the ETA 581. In the FY2014 annual State Quality Service Plan submitted to the U.S. DOL, VDOL reported revamping its audit selection strategies to focus on the effective audit measure criteria." VDOL also indicated that there was no evidence that any VDOL decision making was negatively impacted by data errors. Our draft report did not conclude that decisions were negatively impacted. However, to clarify this, we added that there was increased risk that incorrect decisions were made.

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The SAO report states that *"30 investigations first started in 2011 have not been completed and 134 cases categorized as active are assigned to investigators no longer employed by VDOL"*. The SAO was made aware of the challenges the Department faced during the past three years relating to personnel matters. The WC Investigative Unit, (authorized for staffing of 1 supervisor and 4 investigators), had two investigators out on medical leave due to serious illnesses (one of whom passed away); one investigator separated during Original Probation; one investigator was absent for a substantial period of time due to a work-related injury; one temporary employee who left to accept a permanent position with another employer. Essentially, the unit was functioning during much of the identified timeframe with the supervisor and an investigator. It is not always possible in state government to expeditiously address personnel and hiring challenges.

SAO Comment 5

WC has not developed protocols for case reassignment or established case management practices such as standards for maximum caseloads per investigator, timely case completion, and case prioritization. These standards are especially important in the event of the staffing issues described by VDOL. Without these standards, the program did not reassign cases when investigators left the department, including some cases with employee injuries and stop work orders, and allowed multiple cases from 2011 to remain outstanding. Had such standards existed, it's possible that older cases and cases with stop work orders and employee injuries may have been prioritized and completed.

All cases noted by the SAO are being checked to determine if a proper WC policy is in effect, and if no policy is evident, the investigation will continue; otherwise, the cases noted will be closed.

The Department has its legal division staff working on protocols for case assignment, review and action.

SAO Comment 6

We requested documentation that demonstrates the legal division is working on protocols. VDOL provided a copy of handwritten notes on the existing WC investigation procedures manual and appended handwritten notes of an outline for the procedures manual, including the addition of a section for caseloads and timeframes. These notes appear to indicate that VDOL intends to develop some protocols for WC investigations.

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Objective 2 Finding, page 5:

The MOU between VDOL, BGS and AOT was written in response to the statutory provision requiring VDOL to consult with BGS and AOT before finalizing a debarment action against any employer. The MOU was not written to incorporate provisions for information sharing. The 2012 Executive Order, section II (G) calls for the Task Force to *"Identify barriers to information sharing and recommend statutory changes where necessary"*. The state agencies do cooperate with information sharing, but it is clear that additional efforts and formal MOU's are still needed.

SAO Recommendation, page 6:

The SAO report recommends *"1) Establish the Employer (sic) Misclassification Task Force as required by the Executive Order"*. The Task Force is already established and has met as a full group on three occasions, while other meetings have taken place between VDOL and other agency staff on misclassification issues (BGS, Financial Regulation, Taxes, Human Services, Commerce, and Liquor Control).

The meetings have not taken place every two months as called for in the Executive Order. VDOL has scheduled and will have held three meetings this 2015 calendar year. It is difficult to schedule a meeting every 8 weeks among state agency secretaries and commissioners, particular with the legislative commitments from January to May each year. Even with the ability to appoint designees, many of the appointing authorities are interested in participating themselves or sending key leaders from their agency to serve in their stead, and finding common times for these meetings has been problematic.

SAO Comment 7

With regard to VDOL's comment about three task force meetings, see SAO Comment 1. In addition, SAO amended the language of the recommendation in the report highlights (page six) to reflect the actual recommendation reported in the draft report page 43 which is to schedule Misclassification Task Force meetings and ensure that all required actions are addressed.

In the draft report, SAO provided examples of VDOL collaborating with other state agencies. Subsequent to SAO providing the draft report to VDOL for comment, the department provided documentation which showed that it also had worked with the Secretary of State's Office to ensure that amusement ride operators had WC insurance. SAO included this as another example of information sharing between VDOL and other government organizations.

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The SAO report, page 6, recommends *"2) increase the use of targeted selection criteria for UI Audits"*. VDOL believes that the method we use (whereby the majority of our audits are "random", with logical methodology), is a fair and non-biased way to approach misclassification audits. Our audit selection includes measures that ensure we look at each industry sector in Vermont. Unless there are specific reasons, we do not "target" an industry. All industries have the capacity to misclassify. Vermont is not heavily dominated by any one industry, as is the case in other states. We do not have the significant use of undocumented workers, as is the case in other states. VDOL has specifically chosen not to follow the *"sweep team"* or "SWAT" models (see SAO, page 14) employed in New York or Massachusetts. As pointed out by the SAO report, in 2014 VDOL conducted 71% "random" investigations and 29% "targeted" investigations. Targeted investigations are often determined by a review of SUTA 'dumps'; an employer issuing many 1099's; complaint or fraud tips, or information sharing from other VDOL units or other state agencies. If a particular industry's practices are demonstrating high incidence of misclassification, the Department can, and has, taken steps to 'target' or put a closer lens on that industry. Generally, however, we believe a review of a cross-representation of businesses, utilizing the NAICS codes and a regular-schedule, is appropriate. VDOL believes our current approach to initiating and conducting an investigation is fair to the Vermont employer community, while still protecting the Vermont workers.

SAO Comment 8

VDOL disagrees with our recommendation to increase the percentage of UI field audits that are conducted based upon targeted audit selection criteria, indicating that the method they use (whereby the majority of the audits are random) is a fair and non-biased way to approach misclassification audits and objecting to targeting by industry. However, the U.S. DOL guidance for audit selection techniques does not indicate that fair and non-biased are relevant criteria for audit selection. In fact, the U.S. DOL Employment Security Manual encourages states to utilize audit selection criteria that indicate noncompliance (e.g., targeted selection criteria). Furthermore, the U.S. DOL OIG found that states with top performing field audit programs were those states that designed ways of selecting employers with the highest likelihood of noncompliance, rather than simply selecting employers at random. We reported this on pages 17-18 of the draft report, noting that increased use of targeted selection could improve detection of misclassification. Industry is one of many criteria we list in the draft report. Others include high employee turnover, sudden growth or decrease in employment, location of employers and results of prior audits as criteria that indicate greater risk of noncompliance. The SAO did not address which targeted audit selection techniques VDOL should use to perform targeted audit techniques. The SAO leaves that determination to management.

SAO reported that in 2014 VDOL selected 29 percent of field audits using targeted audit selection techniques and 71 percent of field audits using random selection. In its response, VDOL attributed this to investigations, rather than field audits. VDOL conducts investigations, but these are distinct from field audits. While VDOL indicated in its response that they performed targeted investigations based upon complaints, fraud tips, or information sharing from other VDOL units or other state agencies, none of these sources of information were used as part of their targeted field audit selection techniques.

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The SAO report, page 6, recommends *"4) develop the administrative rules necessary to assess all misclassification penalties authorized by the General Assembly"*. VDOL Directors from the UI and WC Divisions are working to bring the amended rules forward through the Administrative Rules process. We anticipate filing on the WC Rule within the month of August 2015, and the UI Rule before October 15, 2015 (as the UI/ESB Rules incorporate multiple sections that will be amended).

SAO Comment 1

The SAO report, page 12, again repeats in two sections the comment that *"prior to July 2015"* no EO Task Force meeting were convened. This is incorrect, as 3 meetings were held since the start of the Task Force.

The SAO report, page 13, 2nd paragraph, states that *"More recently, coordination has occurred with the Department of Liquor Control and the Secretary of State's Office"*. These efforts were initiated and have been ongoing since 2013. VDOL has identified two areas for additional work on the Biz Portal project with Secretary of State: (1) VDOL needs to be notified when someone exits Biz Portal without going to the VDOL website; and (2) If determined as non-liable for UI, VDOL needs a report so that we can check back on that registrant in the future. We are meeting with SOS staff next week on Biz Portal.

SAO Comment 9

Subsequent to SAO providing the draft audit report to VDOL for comment, the department provided evidence that coordination commenced in 2011 with DLC related to licensing and with the Secretary of State for the development of the business registration portal. As a result, SAO clarified the timeframe of the commencement of activity as 2011.

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The SAO report, page 14, discusses cooperative efforts between NY Department of Taxation and Finance and the Misclassification Investigators. VDOL believes that there should be greater coordination and information sharing between VDOL and the Vermont Department of Taxes, as this would result in more effective combatting of misclassification. VDOL Chief Legal Counsel is redrafting the MOU to propose changes to the Vermont Department of Taxes.

The SAO report, pages 15 and 16: *"VDOL UI and WC Programs Not Enforcing and Collecting All Penalties"*

The report appears to conclude that the VDOL does not know if misclassification penalties were collected, and states that *"the department is unable to account for $16,200 in workers' compensation penalty receivables..."* These statements are inaccurate and misleading. The Department is fully aware of what was collected, and all such money is accounted for, but VDOL failed to document those cases where penalty collection was not pursued. The 'unaccountable' $16,200 was cited as a penalty, but no further action to collect ensued. As stated earlier, penalty citations were put on hold based on an internal determination that VDOL needed to engage in rulemaking for appeal proceedings. VDOL is working to file both set of Rules to close the gaps that we believe exist in the administrative process.

SAO Comment 10

VDOL indicated that the issue was a failure to document cases where penalty collection was not pursued. However, as we have reported, the WC program lacked a consistent record-keeping process and had not established a centralized method to account for citation penalty receivables. The WC program left it up to the individual staff attorney that was involved in the penalty citation process to determine how to track penalty citations and collections. This resulted in a lack of record history when staff attorneys left VDOL employment, and as a result, VDOL was not able to provide evidence that these penalties were collected. Based on evidence provided by VDOL, one penalty was originally $35,000. Subsequent to a VDOL appeals hearing, the amount was reduced to $10,000. There is no record of any collection action for that penalty in the WC database. The other penalty was $7,800 for which the employer had established a $200 per month payment plan and had made eight payments for a total of $1,600. To clarify the report, we amended the language to "does not know the collection status of" rather than "is unable to account for."

VDOL also references an internal determination to put penalty citations on hold because VDOL believed it needed to engage in rulemaking for appeal proceedings. Subsequent to commenting on the draft report, VDOL clarified that the determination to put penalty citations on hold does not relate to the collections of penalty accounts receivable and indicated that the department's comment was intended to reemphasize the reason for not enforcing all penalties.

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The SAO report, page 16, recommends changes to the internal fiscal controls for the accounts receivable and collection activities, including billing statements. VDOL's Fiscal Director is working on establishing the fiscal protocols and system integration with VISION. This will support and supplement the data entry into UI CATS system.

SAO Comment 11

Subsequent to VDOL providing management comments on the draft report, the WC Division Director indicated that he was working with the VDOL Fiscal Director to establish the accounting for WC penalty receivables in VISION. The WC Director provided a draft of the procedures to be used for sending penalty receivable information to the VDOL finance division. VDOL also confirmed that data entry into the UI CATS system does not relate to the process of accounting for WC penalty receivables and the comment that "this will support and supplement the data entry into the UI CATS system" is not correct.

Objective 1: UI Changes to Audit Selection Criteria, Unreliable Performance Data, pages 17-18:
In regards to the comments on data errors, VDOL notes that the UI Division had identified and was working to correct data errors prior to the SAO audit. We will continue to work on improving data collection, entry and systems. A significant part of the improvement plan will require greater accuracy from staff performing and supervising the UI audit data entry and reports.

SAO Comment 12

Based on evidence provided to SAO, the UI Division identified data entry errors for field audit wage data during the course of the SAO audit. The other errors noted in the report, double counting audits, reporting incorrect number of misclassified employees identified during field audits, and using audit 53 reports that did not always contain the actual final audit results to input performance data into the CATS 53 screen were all identified during the SAO audit.

We noted in the draft report that UI is part of a multistate project consortium established to procure a more accurate and fully integrated unemployment insurance tax and benefit system. However, the timeline for implementation for all consortium member states is no later than 2019. As a result, we reiterate the need for changes in the near term in order to prevent further duplication and inaccuracies in the audit results reported to management and the federal government.

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SAO Comment 8

Page 17: Use of Targeted Selection Could Improve Detection

VDOL believes that the method we use (whereby the majority of our audits are "random", with logical methodology), is a fair and non-biased way to approach misclassification audits. See VDOL's response to this issue in our comments, pages 3-4.

The SAO report, page 19, discusses the federal ETA 581. The Vermont Department of Labor is consulting USDOL regarding procedures on proper reporting of assignments and audits on the federal ETA 581. VDOL will report in accordance with USDOL recommendations/requirements.

SAO Comment 4

In addition, the SAO report states that *"management has relied on inaccurate performance data to make decisions about the field audit program"*. There is no evidence from the SAO to support this allegation, and VDOL disagrees with this statement.

Page 19-24 Performance Data Reporting, Misclassification (data) Errors, Wage Data Input Error, Errors from Double Counting Audits

The Employer Services Chief will have data entry supervisory reviews conducted in the future. A report has been instituted that compares the data entered in the CATS 53 screen to the data reported on audit reports.

SAO Comment 12

Regarding comments on data errors, VDOL notes that the UI Division had identified and was working to correct data errors prior to the SAO audit. We will continue to work on improving data collection, entry and systems.

As a result of the many limitations of the current "aged" UI COBOLT system, UI has embarked upon the development of a modernized UI system. This system will address Benefits, Tax and Appeals. The system will enhance all aspects of the Unemployment Insurance IT system including misclassification.

Appendix VI
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Page 25: Assignments Not Counted for Federal Reporting

As noted in the SAO report, VDOL has not been counting all UI assignments to review an allegation of misclassification as an "audit". Assignments resulting from complaints and referrals are reported as "assignments" and have not been reported as audits. There are many instances in which the allegation or information is able to be immediately checked to determine fact or accuracy, based upon our own data systems or other verifiable method; and if the allegation is incorrect, we would consider it unsubstantiated and would not open or count that work as an "audit". This could indeed mean that VDOL has been underreporting its misclassification audit efforts. As noted previously, the VDOL is in consultation with USDOL on the proper reporting of assignments. VDOL will report data on the ETA 581 in accordance with the recommendations and requirements provided by USDOL.

SAO Comment 13

A complaint or referral that is checked and considered unsubstantiated is not the type of assignment that we described in the draft report on page 25. The paragraph in the draft report that VDOL refers to shows that according to the UI management, assignments resulting from complaints and referrals have not been reported as field audits, even if the work involved the same steps as a field audit of an employer. The U.S. DOL defines a field audit on the scope of work performed regardless of how an employer is selected (e.g., random selection or referral) for audit.

As a result, we recommended that UI categorize and report the results of UI assignments based upon the nature of the work performed, not the source of the assignment.

Appendix VI
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Page 25-28: WC Has Limited Ability to Measure Results; Standards for Maximum Caseload, Timely Completion, Case Reassignment, and Prioritization:

SAO Comment 5

The SAO report states that "30 investigations first started in 2011 have not been completed and 134 cases categorized as active are assigned to investigators no longer employed by VDOL". The SAO was made aware of the challenges the Department faced during the past three years relating to personnel matters. All cases noted by the SAO are being checked by WC staff to determine if a proper WC policy is in effect, and if no policy is evident, new investigations of the non-compliant companies will be opened; otherwise the cases will be closed. As of June of 2015, all of the vacant WC investigators have been filled, and an administrative staff person has been assigned to assist the WC Investigation unit. The Department is working on protocols for case assignment, review and action.

SAO Comment 6

A VDOL staff attorney and the WC Division director are rewriting the investigation procedures manual to more clearly spell out investigation steps and performance measures, including documentation, data entry, prioritization protocol, and timely completion expectations.

The SAO found that five stop work orders were "outstanding". We believe the SAO term "outstanding" means that they did not find evidence of a SWO rescission. VDOL's practice is to issue a rescission if the business actually obtains Workers' Compensation coverage. In the event that the business closes, or no longer has employees, the SWO stays "on record/active" in order to ensure that the WC violator's record and debarment (when applicable) is preserved; otherwise, the debarment order would have no meaning. As a final note, there is no evidence that any of the five businesses are operating in violation of the stop work order.

SAO Comment 14

SAO highlighted the five open SWOs as an example of the 134 cases that remained assigned to investigators no longer employed by the WC program in order to demonstrate issues that may arise when there are no protocols for case reassignment and prioritization of cases. Since VDOL's comment and subsequent discussion SAO held with VDOL indicated some confusion over the finding, SAO clarified the finding as it relates to SWOs.

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Page 26, paragraph 3:

The SAO may not recognize VDOL's prioritization of investigations by risk hazard with cases involving actual injury. When a worker is injured and there is no WC insurance, VDOL's focus is on getting the employer to pay the injured worker's medical bills and wage compensation directly. In many cases, the uninsured employer has limited assets and the department believes those assets should go toward compensating the injured worker, rather than be sought as penalties which would be paid to the State General Fund, and thus unavailable to the injured worker.

SAO Comment 15

We indicated in the draft report that VDOL prioritized follow-up on complaints and referrals by risk to the uninsured employee (e.g., a roofer has a higher risk of injury than an accountant). However, the circumstances that we found showed that WC had five open investigation records in the WC investigation database that contained references to an injured worker and the cases were assigned to investigators that no longer worked for VDOL.

Further, VDOL's comment regarding its emphasis on the use of employer assets to pay injured workers' medical costs rather than imposing penalties on employers seems to be a policy issue that is unrelated to whether VDOL prioritizes its investigations.

Page 27 paragraph 2:

Even if WC had established caseload numbers for each investigator, the issues noted by the SAO would have existed due to the significant staffing challenges we faced during this timeframe.

SAO Comment 16

SAO recommended that VDOL develop standards for WC case management that include caseload standards for investigators, timeliness of case completion and protocols for case reassignment. Since these standards were not in place for VDOL to utilize to make decisions about the use of the staff resources it had available, VDOL's challenges with completing cases were exacerbated. If caseload standards were established for investigators, these could be used to make decisions about whether to open an investigation. This might have prevented the current circumstance: 77 cases assigned to one investigator, 30 cases that have been open since 2011 and 134 cases assigned to former investigators.

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Page 27-28:

When the WC Investigation Unit was initially created, an Access® Database was set up to track investigations. A subsequent decision was made by a former program supervisor from the Legal Division to add the WC investigations to the UI CATS system, but that created problems almost from the start of that transition. When the program management was transferred back to the Director of WC, the use of the CATS system was terminated and transferred back to the Access® database; but not all of the files in the CATS system successfully transferred.

Page 28-29: Database Shortcomings, Limited Reporting Functionality, Duplicate Records, Data Errors, NAICS:

A new tracking system is being developed by UI, and it is anticipated and planned that WC will also be able to utilize this enhanced system, allowing for a single database tracking both UI and WC complaints. The existing Access® database does have limited reporting functionality, and it is hoped that the new system will address this. The WC Division has assigned one of our administrative support staff to assist the WC Investigations Unit. It will also develop standardized data entry protocols. It is hoped that these steps will reduce data entry errors and duplication. Employer NAICS codes are currently not reported to the Workers Compensation Division with any consistency, hindering the ability to enter this data into the Access® database. Protocols for data collection and entry are being developed.

SAO Comment 17

The new tracking system VDOL refers to is the complaint log which SAO indicated in the draft report was developed by UI and planned to be used by WC as a single system to log complaints, rather than the two different systems WC currently uses. VDOL indicates it hopes that the new system will address the limited reporting functionality of the WC database.

We reported that the WC database has numerous fields for data entry to record information about investigations. These fields include whether a stop-work order was issued or if an employer was cited for lack of WC insurance. However, the WC division never created on-going report capabilities for the various users. This limited the WC division's ability to provide information to support case management or to measure the impact of enforcement.

As designed, the complaint log, once implemented, will provide VDOL with a mechanism to track the receipt and disposition of complaints and referrals, but it does not have fields to capture the same investigation detail as the WC database. Lacking the level of detail that is in the WC database, the complaint log will not contain the information that is needed to support case management or measure the impact of enforcement and it will not address the limited reporting functionality of the WC database.

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Page 33: Internal Control Weaknesses: Although no findings of risk occurrence or activity were identified during this audit, VDOL agrees with the SAO and acknowledges that current system needs to be revised to eliminate risk; (we note that the USDOL Employment Security Manual encourages payment collection by UI field auditors, including cash or check payment collections). We concur with SAO on the risk, and, as such, VDOL is adjusting our procedures to allow only ACH payment from the employer while the UI Auditor is on site. This modified approach will enable to VDOL to comply with USDOL's recommendation while minimizing associated risk.

VDOL Summary Comments from the Commissioner:

The misclassification of employees is prohibited by both federal and Vermont state laws. Misclassification undermines law-abiding/compliant businesses by creating an unfair advantage for the non-compliant business when competing or bidding for work. Misclassification adversely impacts the employee, when benefits such as minimum wage, overtime, family medical and parental leave, unemployment insurance, workplace safety protections, or workers compensation are not provided because the worker is misclassified as an independent contractor. Misclassification creates substantial losses in tax revenues, which undermines our economy. While Vermont's statutory language might need to be clarified and/or updated as it relates to misclassification and independent contractors, the Vermont Department of Labor is statutorily tasked with, and committed to, the enforcement of the law regarding misclassification, and the reader of this report should not be left with any impression to the contrary.

Appendix VII
Comments from the Commissioner of the Department of Buildings and General Services

VERMONT

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Agency of Administration

August 5, 2015

Douglas R. Hoffer
Vermont State Auditor
132 State Street
Montpelier, VT 05633-5101

Dear Auditor Hoffer:

On July 17, 2015 we received a draft report entitled *Worker Misclassification: Action Needed to Better Detect and Prevent Worker Misclassification*. Below is our response to the findings and recommendations outlined in *Table 5*:

1. Amend the self-reporting form to require bidders to provide information regarding any of the contractor's past violations, convictions, or suspensions related to employee misclassification.

   The self-reporting form specifies that bidders are required to provide information of past violations, convictions, or suspensions relative to classification for workers' compensation, but this is not consistent with the Act 54 requirement. Act 54 required contractors to provide details, at the time of the bid, of any of the contractor's past violations, convictions, or suspensions related to employee misclassification, which can include employee classification violations related to unemployment insurance as well.

BGS Response: This finding indicates our documents are not necessarily consistent with Act 54 requirements. The Department of Buildings and General may need to slightly modify our forms. That said, BGS will review language, documents, and forms to ensure compliance.

2. Work with VDOL, DFR, and AOT to clarify and document each organization's role with regard to verification of information reported in the self-reporting and subcontractor reporting forms.

   BGS does not verify information on the self-reporting form related to worker's classification violations or the information on the subcontractor reporting form.

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BGS Response: BGS will work with VDOL, DRF, and AOT to clarify roles and responsibility associated with verification of information provided in the self-reporting and subcontractor forms.

3. Modify procedures to ensure the subcontractors' workers' compensation insurance information is obtained during the course of the project for those subcontractors added subsequent to contract execution.

   BGS's procedures do not include a mechanism that would ensure it obtains the requisite insurance information before the subcontractor begins work.

BGS Response: BGS intends to strengthen language around contractor expectation to ensue subcontractor forms are updated throughout the project and engage Project Managers to ensure contractor compliance.

4. Utilize the procedures designed to meet the requirements of Act 54 Section 32(a)(1)-(3) for projects that are not competitively bid.

   BGS does not obtain the self-reporting form from contractors with sole-sourced contracts.

BGS Response: Although primary focus has been for those projects that are competitively bid, BGS agrees with this recommendation and will apply Act 54 requirements to sole source contracts.

5. Ensure that all requisite documentation is obtained on a timely basis.

   BGS did not receive the subcontractor reporting form until after commencement of work for two contracts reviewed by SAO that utilized subcontractors.

BGS Response: BGS agrees with this finding and has already implemented new requirements to require the sub-contractor reporting form prior to contract execution.

If you have any questions please feel free to contact me at 828-3518 or mike.obuchowski@vermont.gov.

Sincerely,

Michael J Obuchowski

Michael J. Obuchowski
Commissioner

cc: Wanda L. Minoli, Deputy Commissioner
Deb Damore, Director of Purchasing & Contracts
Jeff Lively, General Counsel

VERMONT

Appendix VIII
Comments from the Director of Finance and Administration of the Agency of Transportation

VERMONT

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Agency of Transportation

August 4, 2015

Tanya Morehouse, Chief Auditor
State Auditor's Office
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Montpelier, VT 05602

Dear Tanya:

Thank you for coming to AOT for the exit conference and for the opportunity to submit a response to your recommendations on the Worker Misclassification Audit. Below are AOT's management responses to the recommendations.

Recommendation #1
Agreed. AOT will amend its CA-82 form to include details of any of the bidder's past violations, convictions, or suspensions related to employee classification. The revised self-reporting form will be utilized effective January 1, 2016.

Recommendation #2
Generally agreed. AOT will work with relevant agencies and departments to clarify and document respective roles in verifying information provided to the state by contractors and subcontractors.

AOT Role:
(AOT management response to the Issue as described in the report is divided as follows: "A" below responds to the statement "AOT does not verify information on the self-reporting form related to worker's classification violations". "B" responds to "AOT does not verify…the information on the subcontractor reporting form".)

A. AOT agrees that it does not verify self-reported information about employee classification violations. In order for AOT to verify the violation information provided by bidders on the CA-82 self-reporting form, AOT must have access to a source for reliable data. VDOL is charged with detecting and identifying violations of employee classification laws and regulations. VDOL informed AOT that it does not have employee classification violation information readily accessible to AOT. Until such time as a detailed list of past violations, convictions, and suspensions related to employee misclassification is made available to AOT, beginning January 1, 2016 and on a weekly basis, AOT will email to VDOL a list of bidders from whom AOT received a CA-82 for an upcoming bid. The bid process has an inflexible and aggressive time frame; therefore AOT requires verification of the self-reported information and status of listed bidders back from VDOL within two business days. The weekly email to VDOL will include a statement that if AOT does not receive a response within two business days, AOT will assume that the self-reported information is valid.

At such time as a detailed list of past violations, convictions, and suspensions related to employee misclassification is made available to AOT, AOT will perform its own verifications using the information made available, no longer requiring an email with a two-day turnaround from VDOL.

VTrans

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B. AOT agrees it is not verifying the insurance coverage of subcontractors as submitted by its prime contractors on the subcontractor reporting form. The resources required to verify the information would be significant. Existing contract provisions and statutes offer protection to the state and hold the prime contractor accountable for ensuring that their subs are insured.

For construction contracts, AOT collects subcontractor reporting forms from its prime contractors. The form requires the prime to list its subcontractors and to name each subcontractor's insurance carrier, as required under Act 54. Beginning January 1, 2016, in addition to submitting the subcontractor reporting form to AOT, listing all subs and their insurance carrier, AOT will require its prime contractors and consultants to collect evidence of worker's compensation insurance from all subcontractors and subconsultants and to have it available for random, periodic audit by AOT. AOT will amend its subcontractor reporting form to include this requirement and will begin using the amended form no later than January 1, 2016.

AOT acknowledges it does not receive a subcontractor reporting form from prime contractors engaged under personal service or professional consultant contracts. See response to Recommendation #4.

Recommendation #3
Agreed. Lack of documentation indicates some employees are not consistently following established protocols and procedures. During 2015/2016, AOT will revise written procedures pertaining to employee classification verification. Appropriate staff from all relevant divisions will be trained in the effective verification and documentation of AOT's contractor employee classification responsibilities.

Recommendation #4
Agreed. "Procedures For Selecting Contractors and Specifications For Contractor Services" was last revised in August 2008, prior to Act 54. AOT will update its procedures for the procurement and administration of non-construction contracts, to incorporate Act 54 revisions and forms, no later than February 1, 2016. Beginning Feb. 1, 2016 AOT expects all contracts to be in compliance with Act 54 of 2009.

If you have any questions related to VTrans' response to the Auditor's findings and recommendations, please contact me.

Sincerely,

Faith I. Brown
Director of Finance & Administration

cc: Sue Minter, Secretary of Transportation
Chris Cole, Deputy Secretary of Transportation
Cathy Hilgendorf, Audit Chief