

Are You Ready for An Audit?

BY ADAM BONSKY

The American Recovery and Reinvestment Act (ARRA) created some welcome business opportunities for government contractors, but with those opportunities comes the increased likelihood contractors working on a project funded with ARRA dollars will be audited.

The ARRA includes funds dedicated to compliance and enforcement in alignment with President Obama's pledge for transparency and accountability for taxpayer dollars spent as part of the \$787 billion economic stimulus package. The U.S. Department of Labor (DOL) is adding hundreds of auditors to its staff, and the Obama administration is cracking down on contractors that fail to comply with laws that apply to federally funded projects.

Several of the government's initiatives focus on employee classifications, wages and benefits—each of which carries the potential for an audit.

INDEPENDENT CONTRACTOR OR EMPLOYEE?

In the past 18 months, the government has paid particular attention to the issue of employers misclassifying workers as independent contractors when, in fact, they are employees. In February 2009, the Internal Revenue Service (IRS) announced the Employment Tax National Research Project (NRP) with the goal to "collect data that will allow the IRS to understand the compliance characteristics of employment tax filers." In February, the NRP began auditing the first 2,000 firms, focusing on five key issues: worker classifications, officer compensation, reimbursement expenses, fringe benefits and non-filers.

In December 2009, the Taxpayer Responsibility, Accountability and Consistency Act of 2009 was introduced with the intention to "revise Section 530 by requiring employers to possess a reasonable basis for designating certain workers as independent contractors." It also looks to ensure workers are provided with workplace protections, including "workers' compensation, Medicare, Social Security, minimum wage, overtime and unemployment compensation." ►

ARE YOU READY FOR AN **AUDIT**?

In March, the DOL announced a joint DOL-IRS "Misclassification Initiative" designed to improve enforcement of workplace laws, with particular emphasis on employers that wrongly classify employees as independent contractors in an effort to avoid paying employment taxes, benefits and overtime. The DOL earmarked an additional \$25 million in its 2011 budget for this effort. The DOL's Wage and Hour Division received an additional \$12 million and 90 new investigators to expand its enforcement efforts.

The DOL also will reward states that successfully detect and prosecute employers that fail to pay the proper taxes. This pilot program received \$10.9 million in funding. The DOL budget includes \$1.6 million for the Office of the Solicitor to enhance enforcement strategies and to promote legislative changes aimed at rectifying the misclassification of employees as independent contractors.

That's not all: in late April, DOL Deputy Secretary Seth Harris announced a "Plan, Prevent, Protect" strategy, which seeks "to put the onus on employers to demonstrate compliance with the misclassification initiative." Specifically, the strategy would require employers to formulate a plan to comply with labor laws; enhance prevention by executing the plan and performing an analysis of its effectiveness; and protect workers by ensuring employers disclose and follow through with the plan.

The misclassification issue attracted further attention with the April 22 introduction of the Employee Misclassification Prevention Act, which would amend the Fair Labor Standards Act (FLSA) to "require persons to keep records of non-employees who perform labor or services for remuneration and to provide a special penalty for persons who misclassify employees as non-employees."

In addition to these federal initiatives, many states have taken steps to identify misclassified workers. Last year, Delaware enacted a law specifically targeting the construction industry. Other states cracking down on misclassification include Maryland, Colorado, Illinois, Indiana, Minnesota, New Hampshire, New Jersey, Rhode Island and Washington.

Information to help employers deter-

mine whether workers are independent contractors or employees can be found at www.irs.gov.

SWEEP AUDITS

An issue garnering attention among government contractors is "sweep audits." "Teams of three to five investigators are visiting worksites and examining everyone on the project," explains Kevin Frankovich of CGR Associates. "Prime contractors need to understand that they are responsible for whether their subcontractors—and any subs their subcontractors are using—are in compliance with applicable laws such as the Davis-Bacon Act."

For example, Frankovich says it's possible that a fourth-tier subcontractor brought in to install cabinets may not even be aware that it is covered by the Davis-Bacon Act while working on an ARRA-funded project. "It's imperative that prime contractors ensure all subcontractors on an ARRA-funded project, or any project to which the Davis-Bacon Act applies, understand their obligations under the law," Frankovich says.

Because the audits are random and unannounced, government contractors must keep impeccable records at all times. With the increased number of investigators on staff at the DOL, it's possible any contractor working on an ARRA-funded project will be audited.

DOCUMENT, DOCUMENT, DOCUMENT

The burden of proof is on the contractor in an audit or inquiry situation. When a company is being investigated, the DOL will review whether the benefit portion of the prevailing wage is actually being contributed to a bona fide benefit plan. Some of the documentation the DOL may require includes:

- plan documents, adoption agreement(s), summary plan descriptions and summary annual reports;
- Schedule As;
- Form 5500s;
- fidelity bond information;
- U.S. Census documentation;
- distribution forms and Form 1099s;
- schedule of contributions received; and
- nondiscrimination testing results.

Assembling this information is extremely time-consuming, even for the most organized

contractors. With this in mind, government contractors should pay particular attention to:

- **Using the correct job categories for workers.** "Sometimes, in an effort to save money, contractors will classify a worker as a laborer when, in fact, he is a carpenter and must be paid carpenter's wages," Mike Rogers, chief compliance officer of Fringe Benefit Group, says. If a worker performs several job duties on a project, hours must be broken out according to which function and job classification is being performed, and correct wages must be paid for each.
- **Frequency of contributions to bona fide benefit plans.** While the Davis-Bacon Act requires that fringe benefit contributions for hourly workers be made at least quarterly, Rogers recommends that contractors make contributions monthly. "It just makes documentation and recordkeeping easier for the contractor," he says. "And with monthly contributions, it's easier to catch and correct errors in a timely fashion."

THE COST OF NON-COMPLIANCE

Penalties for failure to comply with the various laws associated with ARRA-funded projects can be steep and may include debarment from work on public works projects. One way to make navigating the maze of regulations easier is to partner with a benefits company that has experience assisting clients with compliance and the audit process.

When choosing a bona fide benefits partner, contractors should investigate how long that provider has worked with government contractors, and whether compliance assistance is provided in-house or outsourced at an additional cost. Contractors also should look for a partner that has experience with compliance audits.

As ARRA dollars continue to flow—it's imperative that contractors prepare for the arrival of auditors to check on how these dollars are being spent. Taking steps now will mean less downtime for the business when the auditors appear and start asking for information.

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