How I Survived My NYS DOL Audit

The Scope and Scoop

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In General
The NYS Department of Labor has increased the number and frequency of audits.

Audits have two lines of investigation:

- Are you paying your employees correctly?
  - Pay for all hours worked
  - Pay the minimum wage
  - Pay overtime when due
  - Provide benefits

- Have you paid the required contributions and maintained the types of coverage on behalf of all employees?
  - NY State Workers Compensation
  - NY State Unemployment Insurance
  - NY State Disability Insurance
The Notification of Audit

- The call: The NYS DOL auditor called the payroll manager on July 21 to schedule an on-site audit for August 16.

- The follow-up email: The auditor requested 2 pages of 2010 information in advance.

- The on-site visit: The auditor quickly honed in on the 1099s, revealing that it was an issue of employment classification.
The 1099 Situation

- We had contracted with individuals to provide training (in our offices), technical assistance, and program evaluation to after-school programs.
  - Many were retained year after year.
  - Some were graduate students.
  - Some were former employees.
  - Some were later hired as employees.

- In 2010, we issued 48 1099s, with payments totaling $292,397.
The Meeting with the Auditor:  
She Said-He Said

- **My claim: None were employees because:**
  - the contracts stated that they were independent contractors, without rights to benefits, etc.
  - they worked for other organizations—in some cases, on a full-time basis.
  - they performed their work without our oversight.
  - they had specialized expertise.

- **His claim: All were employees because:**
  - the contract language alone was insufficient to make them consultants.
  - it didn’t matter that they worked for others—people can have two jobs.
  - they worked on our premises and we oversaw their work.
  - they did not have a website which advertised services.
What Came Next

- In October, we received an audit report which claimed we had underreported compensation for 2008, 2009, and 2010!
  - The state may go back 3 years, so the auditor extrapolated our underreporting in 2010 to 2008 and 2009.

- With the audit report came a request to pay $25,700 in unpaid unemployment taxes plus interest based on the auditor’s findings that:
  - 50% of our 1099 consultants should have been treated as employees over the 3 years.
  - When the payments were treated as compensation, we had unreported taxable wages of $311,449 for the 3 years.
I contacted our attorney, who advised that:
• the state had increased the frequency of its audits to raise money.
• we should pay the amount requested, lest we continue to accrue penalties.
• we should request a hearing, which would take months to get, and which we probably would not win.

I contacted the auditor’s supervisor to:
• explain the situation, hoping he would be more reasonable.
• ask him to allow us to provide more information for previous years, such as the actual payments, rather than rely on extrapolated amounts.
• advise him we were requesting a hearing.
Control the Damage

- Based on the follow up information we provided, the auditor reduced our taxes and penalties by more than 75%, from $25,700 to $6,309.

  - The auditor agreed to exclude certain consultants who:
    - lived outside the metropolitan area
    - were "doing business as"
    - had specialties (e.g., photography and graphic design) that were unrelated to our core business

  - The actual amounts for all the 2008 and 2009 1099s totaled lower taxable wages than the auditor’s extrapolation.
# By The Numbers

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<tr>
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<th>1099s</th>
<th>Initial Audit Findings October 2011</th>
<th>Final Audit Report March 2012</th>
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Life After the Audit: What We Did Differently

- We amended our process for hiring consultants.
  - We became more aware of language in our agreements. For example, we stopped using “reports to” and “provides weekly reports,” which suggests employer-level control.
  - We requested proposals from consultants, which substituted for our scope of work.
  - We paid individual’s organizations whenever possible.
  - Graduate students became part-time employees.
  - We avoided hiring recently terminated employees.
Advice

- Be prepared and provide all of the information requested.
- If you do the grunt work for the auditors, they are more likely to use your data.
- Understand what you are handing over and know where your weaknesses are.
- Clearly explain your operation to the auditors; they need context for what they’re looking at.
- Always cooperate with the auditors, even when you don’t want to, because it increases your chances of reasoning with them.