



INTERNAL AUDIT REPORT

LIMITED OPERATIONAL AUDIT

ON/OFF-BOARDING OF CONSULTANTS AND CONTRACTORS

JANUARY 2016 – SEPTEMBER 2017

ISSUE DATE: DECEMBER 12, 2017

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EXECUTIVE SUMMARY

Internal Audit (IA) completed an audit of the Port of Seattle's (Port) on and off boarding process of consultants and contractors for the period January 2016 – September 2017. The audit was performed to assess the design and operating effectiveness of internal controls.

Management controls were not adequate to ensure compliance with Port Policy and Internal Revenue Service (IRS) requirements. We identified two opportunities to improve internal controls to enhance Management's monitoring of independent contractors and contingent workers. These opportunities are discussed in more detail, beginning on page six.

- The Port's Contingent (Contract) Workers Policy [(the Policy) EX-10] needs to be updated with recent IRS and case law guidance.
- A process has not been established to account for and manage/monitor on and off-boarding of contingent and contract workers.

We extend our appreciation to management and staff in the Port's Central Procurement Office, Human Resources, and Legal Department for their assistance and cooperation during the audit.



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RESPONSIBLE MANAGEMENT TEAM

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BACKGROUND

The Port's Contingent (Contract) Workers Policy (EX-10), establishes procedures so that independent contractors and temporary agency employees (contingent workers) are used appropriately and lawfully.

The Policy defines an independent contractor as an individual or vendor who contracts with the Port to perform in a non-employee status and meets Internal Revenue Service (IRS) criteria.

Temporary agency employees or contingent workers are employed by an outside agency, on a specific project, for a limited duration, and performance issues are conducted by the outside agency.

Regardless of classification (contingent, consultant, independent contractor, etc.), the IRS considers these individuals independent contractors and has developed criteria to determine their classification. The criteria are streamlined into three general categories:

- 1) **Behavioral control:** The payer has the right to control or direct **only** the result of the work and not what will be done or how it will be done.
- 2) **Financial control:** How the individual is paid, e.g., weekly or hourly versus a flat fee.
- 3) **Type of Relationship:** How permanent and how the Port and individual contractor views the relationship.

Generally, the greater the behavioral and financial control, and the more permanent the relationship is, the greater the likelihood that the individual would be considered an employee.

AUDIT SCOPE AND METHODOLOGY

Our audit was conducted in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. Those standards 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.

The period audited was January 2016 – September 2017. We performed the following procedures:

To obtain an understanding of the program audited, we interviewed management, reviewed policy and procedural documents, and performed the following procedures:

- 1) Reviewed policy document EX-10 Contingent (Contract) Workers.
- 2) Manually identified over 250 independent contractors throughout the Port. Selected 29 “workers” and performed the following procedures:
 - Determined whether they had worked with the Port over 12 months.
 - Reviewed the type of work performed.
 - Determined whether a parking pass was provided.
 - Determine if the individual worked under a professional, personal, or purchasing agreement.
- 3) Conducted interviews with Port management to assess the general awareness of IRS rules and Port Policy requirements.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

1) RATING: HIGH

The Port’s Contingent (Contract) Workers Policy (the Policy) needs to be updated with recent IRS and case law guidance.

Policies are the foundation of an internal control environment. They provide organizations with useful and necessary information on how to make responsible and informed decisions in a consistent manner. When Policies are clear, accurate, and concise, they can raise employee awareness of regulatory and Port requirements.

The Port’s Contingent (Contract) Workers EX-10 Policy, however, has not been updated in almost 10 years, is not consistent with recent IRS guidance and case law, and is not presented in a way that is easily understood.

For example, the Policy states “The Port is responsible for directing the work...” which is not consistent with IRS guidance that states an organization, “has the right to control or direct only the result of the work and not what will be done and how it will be done”.

The Policy also states “Independent contractors may deliver services through a Professional Services Agreement for a one year period.” IRS guidance evaluates the type of relationship and how permanent the parties view the relationship, but does not limit the duration. Furthermore, the Port frequently enters into contracts extending beyond one year.

Finally, the Policy defines contingent workers as temporary agency employees or independent contractors each with a different set of requirements. The IRS, however, does not distinguish between the two classifications. Rather these “workers” are considered independent contractors with one set of evaluation criteria.

Managing or treating independent contractors like employees increases the likelihood that the IRS would consider those individuals as employees. The classification of employee or independent contractor impacts income tax withholding and benefits, which are offered to employees, but not independent contractors.

Recommendation:

Central Procurement, Human Resources, and the Port’s Legal Department need to evaluate and re-write the Port’s Policy. This evaluation should include recent IRS guidelines, case law and other information relevant to the Port. The evaluation should also identify who will monitor general compliance with Policy requirements.

Management Response:

Dave Caplan will lead a team with representatives, including but not limited to, Human Resources and Development, Central Procurement Office, ICT, Legal and Capital Development to develop an updated EX-10 Policy addressing the issues. This policy will be developed by March 30, 2018.

2) RATING: HIGH

A process has not been established to account for and monitor/manage on and off boarding of independent contractors and contingent workers.

The Port does not maintain a list of contingent workers or have a standard process (i.e. a checklist) to on and off-board independent contractors (consultants and contractors). As a result, these workers may not be used “appropriately and lawfully”.⁽¹⁾

Internal Audit manually identified more than 250 individuals (non-Port employees) working at the Port. We selected 29 individuals and identified the following exceptions:

- Nine individuals worked more than 12 months without a break in service. One of these individuals began working at the Port dating back to 2002. According to Port Policy, no individual may provide services through a temporary agency to the Port in excess of 12 months without a 90-day absence from the Port.
- Thirteen individuals received Port paid parking cards which is not allowed by Port Policy.

These exceptions illustrate that an effective monitoring process has not been established. This process should not only monitor breaks in service and Port paid parking, but should also validate that system/logical access is removed and badges, keys, laptops are collected prior to the individual’s last day.

We also observed that contractors are not provided with core training. Although Internal Audit recognizes that a training program should not mirror that of a Port employee, consultants/contingent workers should be provided with certain core training material. This training program should include: 1) emergency evacuation, 2) fire prevention and extinguisher use, and 3) Port ethics and integrity, and policies regarding the use of Port IT systems.

Recommendation:

- 1) Institute a system to track non-port workers. This system should include the individual’s name, the responsible manager, start/estimated end date, department, and type of service contract.
- 2) Develop a standard on and off boarding program that establishes processes so that contractors have necessary information, training, and access to perform their role, while also meeting Port minimum requirements.

Management Response:

Dave Caplan will lead a Port-wide team to develop the processes, procedures and structure to address this audit finding by June 29, 2018. A representative from the Continuous Process Improvement team (Lean) will play an important role in facilitating development of the processes, procedures and structure.

⁽¹⁾ Port Policy EX-10 states as the purpose “To assure temporary agency and independent contractor services are used appropriately and lawfully.”

EXHIBIT 1- POLICY EX-10 CONTINGENT (CONTRACT) WORKERS

I. STATEMENT OF THE POLICY:

It is a policy of the Port to assure that the services of contingent workers are used appropriately.

II. DETAILS:

A. Purpose:

1. To define contingent workers.
2. To assure temporary agency and independent contractor services are used appropriately and lawfully.
3. To establish procedures related to the use of temporary agency services and independent contractors.

B. Definition:

Contingent workers are temporary agency employees and independent contractors providing services to the Port.

C. Temporary Agency Employees:

1. These workers are employed by an outside agency.
2. Their time is billed to the requesting department's Port Procurement Card by the outside agency.
3. Temporary agency employees work for a limited duration on a specific project.
4. The Port directs their work and provides the necessary equipment.
5. Performance issues are handled by the outside agency.

Accessing Temporary Agency Services:

All requests for temporary agency services must be submitted to the Port Contract Administrator in Human Resources and Development. Requests for temporary agency services should include:

- Department name
- Requestor's name
- Phone number of Port staff overseeing the assignment
- Length of the assignment
- Preferred start date
- Description of the assignment and skill required, and,
- Department's Procurement Card number and subclass

Services may be delivered by temporary agencies for six (6) months. Written requests for extensions must be approved by the Director, Human Resources and Development. Requests must include the reason for the extension and a date certain for end of the service. These requests will be honored only in rare circumstances and in no case will an extension exceed six (6) months.

The Human Resources and Development Department will monitor this function and notify temporary agencies of the end of the six-month assignment unless the assignment ended earlier or a request for extension has been approved.

Employees of Temporary Agencies:

Employees of temporary agencies are not eligible for Port training offerings, recognition programs, Port-paid leave, or any other Port employee program.

Port-paid parking is not provided.

No individual may provide services through a temporary agency to the Port in excess of 12 months full time without a 90-day absence from the Port.

The Port is responsible for directing the work of such employees but status issues such as hiring, pay, benefits, and performance issues are managed by the agency.

Rates and Fees:

Hourly rates for services are negotiated between Human Resources and Development and the temporary agency and are set rates for the different levels of service delivered.

Hourly rates for services are not negotiable between temporary agency employees and the department receiving the service.

Human Resources and Development will pay invoices using the receiving department org and subclass information.

Each department using temporary agency services will review and reconcile their Procurement Card charges. All questions regarding charges should be directed to the Port Contract Administrator in Human Resources and Development.

D. Independent Contractors

An independent contractor is any individual or vendor who contracts with the Port to perform service in a non-employee status and meets Internal Revenue Service criteria regarding independent contractors.

Independent contractors are self-employed and in control of both the results and the method of the work or service. They are hired to provide a pre-defined deliverable for a set fee.

Independent contractors typically have other clients, a business license, an office, and equipment.

Independent contractors provide their own project management. The Port has oversight but not direct management responsibility for the independent contractor's work.

Independent contractors may deliver services through a Professional Services Agreement for a one year period. After consultation with Human Resources and Development and Legal Department staff, Port Project Managers may make recommendations for renewal of agreements to the Chief Financial Officer.

III. COMMENTS:

Refer to: [Policy PUR-2 - Acquisition of Goods and Services](#)
[Procedure PUR-2 - Consultant Procedures](#)

For further information contact Rosalee Walz, Nicole Martin

APPENDIX A: RISK RATINGS

Findings identified during the course of the audit are assigned a risk rating, as outlined in the table below. The risk rating is based on the financial, operational, compliance or reputational impact the issue identified has on the Port. Items deemed “Low Risk” will be considered “Exit Items” and will not be brought to the final report.

Rating	Financial	Internal Controls	Compliance	Public	Port Commission/ Management
HIGH	Large financial impact Remiss in responsibilities of being a custodian of public trust	Missing, or inadequate key internal controls	Noncompliance with applicable Federal, State, and Local Laws, or Port Policies	High probability for external audit issues and/or negative public perception	Important Requires immediate attention
MEDIUM	Moderate financial impact	Partial controls Not adequate to identify noncompliance or misappropriation timely	Inconsistent compliance with Federal, State, and Local Laws, or Port Policies	Potential for external audit issues and/or negative public perception	Relatively important May or may not require immediate attention
LOW/ Exit Items	Low financial impact	Internal controls in place but not consistently efficient or effective Implementing/enhancing controls could prevent future problems	Generally complies with Federal, State and Local Laws or Port Policies, but some minor discrepancies exist	Low probability for external audit issues and/or negative public perception	Lower significance May not require immediate attention
Efficiency Opportunity	An efficiency opportunity is where controls are functioning as intended; however, a modification would make the process more efficient				