

To: Board of Directors / Senior Management

From: [Your Name/Audit Firm]

Date: [Date]

Subject: Management Letter: Worker Misclassification and Payroll Risks

Dear Management,

In connection with our recent review of the organization's payroll and human resources practices, we are writing to formally document concerns regarding the classification of workers as independent contractors rather than employees.

1. Identified Condition

A review of service agreements and payment records indicates that several individuals currently classified as independent contractors (1099) perform duties under the direct control and supervision of the organization, using company resources, and during set business hours.

2. Internal Control and Compliance Risks

The misclassification of employees as independent contractors poses the following significant risks to the organization:

- **Tax Liabilities:** Potential assessment of unpaid federal, state, and local income tax withholdings, as well as the employer's share of Social Security and Medicare taxes.
- **Payroll Penalties:** Exposure to significant interest and penalties from the IRS and Department of Labor for failure to file correct information returns.
- **Benefit Exposure:** Potential legal claims for unpaid overtime, minimum wage violations, and retroactive claims for company-provided benefits (e.g., health insurance, 401k).
- **Workers' Compensation:** Lack of coverage for misclassified individuals may lead to direct financial liability in the event of workplace injuries.

3. Recommendations

To mitigate these risks, we recommend the following actions:

- Conduct a comprehensive audit of all 1099 contractors using the IRS "Common Law" rules (Behavioral, Financial, and Relationship controls).
- Convert individuals who meet the criteria of an employee to regular payroll status immediately.
- Implement a standardized "Worker Classification Checklist" to be completed by HR or Legal before any new contractor is engaged.
- Update independent contractor agreements to ensure they accurately reflect a non-employment relationship.

We are available to discuss these findings and assist in developing a remediation plan to ensure full regulatory compliance.

Sincerely,

[Signature]

[Title]