

**VI. DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES  
REQUIREMENTS**

## **PROCUREMENT AND ACCOUNTING PROCEDURES**

### **I. Determine if an Employer-Employee Relationship Exist.**

- A. In order to determine if an employer-employee relationship exist, complete State Accounting Form (SAF) D-40 as required by DAGS Comptroller's Memorandum No. 2006-10.
- B. Refer to IRS training material dated August 2005 for assistance in completing form.

### **II. Procure Services as an Independent Contractor.**

- A. If SAF D-40 determines that an employer-employee relationship does not exist, procure services as an independent contractor.
- B. Use Chapters 103D, HRS to procure personal services. (See SPO flowcharts and procedures at Appendix A).
- C. Use the Attorney General approved contract agreement and attachment templates to prepare a contract for the personal services with the independent contractor.
- D. Submit contractor's billings for payment through the DAGS accounting system.
  - 1. To ensure that payments made to date do not exceed the contract amount, maintain a log of the billing payments.
- E. Prepare a federal form 1099-Miscellaneous for the payments made to the independent contractor for the calendar year.

### **III. Procure Services as a Personal Services Contractor.**

- A. If SAF D-40 determines that an employer-employee relationship exist, procure services as a personal services contractor.
- B. Use Chapters 103D, HRS to procure personal services. (See SPO flowcharts and procedures at Appendix A).
- C. Use the Attorney General approved personal services contract agreement and attachment templates to prepare a contract for the personal services with the personal services contractor. Or
- D. Use the Attorney General approved contract agreement and attachment templates to prepare a contract for the personal services with the personal services contractor.
  - 1. Include the following paragraph in the Attorney General approved contract

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agreement template after the compensation paragraph.

- a. Relationship of Parties. Notwithstanding the fact that the CONTRACTOR may be compensated through the STATE's payroll system and employment taxes are withheld and remitted to the appropriate tax jurisdiction, the CONTRACTOR shall not be considered to be an employee of the STATE in the provision of services under this Contract. Further, the CONTRACTOR shall not be entitled to claim or receive from the STATE any vacation, sick leave, retirement, workers' compensation, unemployment insurance, or other benefits provided to state employees.
- E. Process forms and enroll individual into the State Payroll System.
1. Program/agency.
    - a. Obtain the following from the contractor:
      - 1) Completed Federal Form W-4.
      - 2) Completed Hawaii Form HW-4.
      - 3) Completed "Salary Assignment/Cancellation" form (State Accounting Form D-60), if applicable. Temporarily until a form or payroll procedure is developed.
      - 4) Copy of contractor's social security card.
      - 5) Copy of contractor's picture I.D.
    - b. Complete the Authorization to Pay Individual (Non-Employee) form (State Accounting Form D-41).
    - c. Send the following to the Departmental Personnel Office (DPO).
      - 1) Original Federal Form W-4.
      - 2) Original Hawaii Form HW-4.
      - 3) Original "Salary assignment/Cancellation" form (State Accounting Form D-60), if applicable. Temporarily until a form or payroll procedure is developed.
      - 4) Copy of contractor's social security card.
      - 5) Copy of contractor's picture I.D.
      - 6) Copy of State Accounting Form (SAF) D-40 form.
      - 7) Original SAF D-41 form.
      - 8) Copy of Exemption of Contractual Services Check List.
      - 9) Copy of contract agreement (with attachments).
    - d. For informational purposes, provide individual with copies of the

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following departmental policies:

- 1) Sexual harassment.
  - 2) Unlawful harassment.
  - 3) Any other applicable departmental policies.
- e. Upon receipt of billing invoices from the Personal Services Contractor:
- 1) Prepare a memo to the department's fiscal office including the following information:
    - a) Individual's name.
    - b) Pay type code "E".
    - c) Appropriation number.
    - d) Object code 2800 or 28xx (xx is minor object code).
    - e) Billing amount.
  - 2) Submit the memo and the billing to the department's fiscal office.
- f. To ensure that payments made to date do not exceed the contract amount, maintain a log of the billing payments.
- g. If contract period is within a fiscal year or straddles two fiscal years and payments are made only from the fiscal year's appropriations, no encumbrance is required.
- h. If contract period straddles two fiscal years and payments are made from the first fiscal year's appropriation, an encumbrance is required and the following procedures should be followed:
- 1) At the end of the first fiscal year determine the amount to be encumbered.
  - 2) Prepare a memo to the department's fiscal office requesting that the amount be included with the department's payroll encumbrance and include the following information:
    - a) Individual's name.
    - b) Appropriation number.
    - c) Contract amount remaining to be paid.
2. Departmental Personnel Office.
- a. Upon receipt of the above forms and contract from the program/agency, review and sign the SAF D-41 form.

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- b. Send the following to departmental payroll office:
    - 1) Original SAF D-41 form.
    - 2) Original Federal Form W-4.
    - 3) Original Hawaii Form HW-4.
    - 4) Copy of SAF D-40 form.
    - 5) Copy of contract agreement (with attachments).
  - c. Send the original "Salary Assignment/Cancellation" form (State Accounting Form D-60) (if applicable) to DAGS Central Payroll. Temporarily until a form or payroll procedure is developed.
3. Departmental Fiscal Office
- a. Upon receipt of the program/agency's request to include an amount in the department's payroll encumbrance, include the information provided on the department's form C-06.
  - b. For payments made from current fiscal year's appropriation, upon receipt of the memo from the program/agency and the billing, input the following information on the hourly change schedule:
    - 1) Use pay type code "E".
    - 2) Object code 2800 or 28xx (xx is minor object code).
    - 3) Program/agency's appropriation number.
    - 4) Billing amount.
    - 5) Complete all other required data fields.
  - c. For payments made from prior year's appropriation (payroll encumbrance), upon receipt of the memo from the program/agency and the billing, input the following information on the hourly change schedule:
    - 1) Use "A" for payroll encumbrance.
    - 2) Use pay type code "E" irregular pay.
    - 3) Object code 2800 or 28xx (xx is minor object code).
    - 4) Program/agency's appropriation number.
    - 5) Billing amount.
    - 6) Complete all other required data fields.
4. DAGS Payroll will prepare the annual federal form W-2 for the personal services contractor.

## **FAQ – PERSONAL SERVICE CONTRACTS PROCUREMENT AND ACCOUNTING PROCEDURES**

### **1. Q. Are personal services contracts (PSC) subject to procurement procedures? If so, what is the statutory authority that requires this?**

A. Yes, under the AARC's recommended proposal to the Comptroller, personal services contracts are subject to the Procurement Code, HRS chapter 103D. This is based on the AARC's interpretation of § 103D-102 of the Code.

### **2. Q. Is there a standardized process to obtain services through PSCs?**

A. Currently, there is no standardized process to obtain services through personal services contracts. Departments and agencies have been inventing their own procedures, and the issue of personal services contracts has not been thoroughly addressed.

### **3. Q. Why are PSCs an issue with the IRS?**

A. Soon after the AARC was formed to research and recommend suggested improvements to auditing and accounting methods and procedures to the Comptroller, it learned of the IRS audit of Delaware. One of the IRS's concerns was contracts between states and individuals, specifically, that the appropriate taxes were not being withheld by the states even though the contractors were not treated as independent contractors, but as employees (according to the IRS test to determine whether an employer-employee relationship exists). The IRS had notified the states, including Hawaii through DAGS, that this was a growing concern. The Attorney General was also notified.

DAGS and the AG informed the IRS they would address this concern. The AARC then proceeded to research the issue and identified the primary problem as the personal services contracts. Surveys issued by the AARC revealed that certain departments rely heavily on personal services contracts and wanted to continue using them to fulfill the departments' responsibilities.

### **4. Q. How can PSCs be used without incurring IRS penalties and interest?**

A. On the premise that departments want to continue to use personal services contracts, and to avoid probable IRS back taxes (and penalties and interest), the AARC developed a proposed process for personal services contracts to submit to the Comptroller. Because the need was immediate, the AARC looked to current law, rather than draft proposed legislation. Based on existing law, the AARC concluded the Procurement Code was the best legal support for the proposed personal services contract process because the Code can be interpreted to include personal services contracts. (The Code does not apply to the selection of and payments to employees, but arguably does apply to contractors treated as employees for IRS

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purposes, but are not employees for State purposes.)

**5. Q. *Is there any definition or clear authority for the use of PSCs?***

A. No, accordingly in the absence of any clear legal authority governing personal services contracts, the Procurement Code is the basis of the AARC's recommended proposal to the Comptroller.

**6. Q. *Under the AARC proposal will departments be required to use procurement procedures for PSCs or will they be permitted to simply "pick them off the street"?***

A. Under the AARC proposal, departments will be required to follow procurement procedures, but may select someone "off the street" if they are able to obtain an exemption from 103D from their Chief Procurement Officer under § 103D-102(b)(4)(L).

**7. Q. *Is the procurement process what makes the difference between an employee and a PSC?***

A. Yes, it is one of the distinctions. The proposed personal services contract process requires the Procurement Code to be followed when the conventional personnel hiring process is not used which in turn is contingent on the position being filled or if there is no position but the department needs the services.

**8. Q. *If staffing agencies are not PSCs, are they independent contractors?***

A. Yes, the IRS has opined that staffing agencies are independent contractors (as well as the individuals who are sent by staffing agencies to provide services to the states) and not employees for purposes of federal taxes.