

**U.S. Department of Labor
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**THE WAGE AND HOUR DIVISION'S
ADMINISTRATION OF SPECIAL MINIMUM
WAGES FOR WORKERS WITH DISABILITIES**

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ACRONYMS/ABBREVIATIONS

ADA	-	Americans with Disabilities Act
CFR	-	Code of Federal Regulations
CPS	-	Certification Processing System
CRP	-	Community Rehabilitation Program
CY	-	Calendar Year
DOL	-	United States Department of Labor
ESA	-	Employment Standards Administration
ETA	-	Employment and Training Administration
FOH	-	Field Operations Handbook
FY	-	Fiscal Year
FLSA	-	Fair Labor Standards Act
JTPA	-	Job Training Partnership Act
MIS	-	Management Information System
OIG	-	Office of Inspector General
SMW	-	Special Minimum Wage
SSI	-	Supplemental Security Income
TWWIA	-	Ticket to Work and the Work Incentives Improvement Act
WHD	-	Wage and Hour Division
WHISARD	-	Wage and Hour Investigative Support and Reporting Database
WIA	-	Workforce Investment Act

GLOSSARY OF TERMS

Commensurate Wages - Wages based on the worker's individual productivity, no matter how limited, in proportion to the wage and quantity of work performed in the same job in the geographic area from which the labor force of the community is drawn.

Compliance Review - The review of the Special Minimum Wage certificate applications and the accompanying documentation to determine if the employer is complying with Section 14(c) regulations.

Partnering - The association or relationship between various sources providing services that would strengthen the mission or goal of the program. Partnering involves the coordination of other public programs.

Prevailing Wage - A wage rate that is paid to an experienced worker not "disabled for the work performed."

Productivity Studies/ Time Studies - The industrial work measurement methods, such as, stop watch time studies, predetermined time system, standard data, and other methods used by the employer to establish standard production rates of workers not "disabled for the work performed."

Work Measurement - The process of determining the amount of time it takes a worker who does not have a disability to perform an operation or an element of an operation using a prescribed method. This amount of time becomes the "standard" against which the productivity of the worker with a disability is compared to determine the commensurate wage.

Special Minimum Wage - Wage that is authorized under a certificate issued to an employer and is less than the statutory minimum wage.

EXECUTIVE SUMMARY

The Fair Labor Standards Act (FLSA), enacted in 1938, established fair labor standards for the employment of workers in industries engaged in interstate commerce. Included in the Act are provisions related to the establishment of minimum wage rates, including a special minimum wage for people with disabilities. Section 14(c) of the FLSA was amended in 1986 to modify provisions related to the employment of workers with disabilities at special minimum wages. Section 14(c) authorizes employers, after receiving certificates from the Wage and Hour Division (WHD), to pay workers with disabilities less than the Federal minimum wage. The WHD operates the Special Minimum Wage (SMW) program and issues employers certificates authorizing the payment of subminimum wages. The majority of WHD Section 14(c) program resources are devoted to conducting compliance reviews of employers during the certification process.

The Office of Inspector General (OIG) audited WHD operations and selected employers that were issued certificates under Section 14(c) for onsite reviews. Our main objective was to determine how effectively WHD managed the SMW program. Another objective was to determine whether WHD and employers operating under the program were partnering with the workforce investment system administered by the U.S. Department of Labor (DOL) and other Federal agencies to improve employment opportunities for people with disabilities.

Audit Results

We identified several factors that affected WHD's ability to administer the certification program effectively and efficiently. Specifically, we found WHD: 1) placed a low priority on Section 14(c) activities; 2) had an unreliable Management Information System (MIS); and 3) adopted policies that resulted in the assessment of back wages as low as 1 cent.

The WHD management of the SMW program offers little assurance that employers are complying with program requirements. Numerous problems were noted with employers who either did not understand or were not following Section 14(c) requirements when determining commensurate wages paid to their employees. Furthermore, employers generally assumed they were in compliance with program requirements simply because they had been issued certificates by WHD.

The technical assistance provided to employers by WHD was limited to providing information during the compliance review process. At most sites visited, employers stated that communication between them and WHD was minimal, and they would like WHD to be more proactive in providing information on program requirements. Conducting onsite monitoring and compliance reviews and providing employers with technical assistance will help ensure employer compliance with critical Section 14(c) requirements.

Conclusions

During our audit period, WHD started taking steps to improve the management of the SMW program. The WHD improved Midwest Regional Office operations by adding a new manager to direct program operations. Increased emphasis was placed on ensuring applications sent by employers are correctly completed and contain all the required information. Also, steps were taken to improve the management information system used to track certificates and report on program statistics. Finally, the Field Operations Handbook (FOH) was being updated, and WHD plans to provide increased staff training, education and outreach.

We commend WHD for its efforts. However, improvements are still needed in the areas of program management, strategic planning, monitoring, technical assistance, and partnering. Data base management deficiencies still need to be addressed, the FOH update needs to be issued, and ESA's strategic planning process must provide for increased technical assistance and more on-site reviews. Finally, by becoming more involved in the workforce investment initiatives funded by DOL and other Federal agencies, WHD could assist Section 14(c) employers and employees in taking advantage of programs and services available through these other Federal programs.

Recommendations

We recommend the Assistant Secretary for the Employment Standards Administration (ESA):

- 1) Include in ESA's strategic planning process a program for increased Section 14(c) onsite monitoring and enforcement.
- 2) Develop an "action plan" to improve WHD's Section 14(c) program management operations by:
 - correcting database management inaccuracies and deficiencies,
 - ensuring that all statistical reports can be supported and validated,
 - implementing controls to ensure the integrity of data entered into the MIS (i.e., through the use of statistical sampling methods),
 - issuing updated policies and procedures, and
 - developing a policy that assesses employers for only material amounts of back wages.
- 3) Increase technical assistance to Section 14(c) employers by:
 - providing employers with written guidance on Section 14(c) requirements, and
 - engaging outside organizations or individuals with knowledge of Section 14(c) requirements to provide technical assistance to employers.

- 4) Establish an Advisory Committee or consider other methods to solicit recommendations from government officials, employers, employees and advocates on needed program guidance and legislative reforms.
- 5) Establish partnerships with DOL's Employment and Training Administration, the Office of Disability Employment Policy, and other government agencies involved in the employment and training of people with disabilities.

WHD officials concurred with our findings and recommendations, and identified steps they have either taken or plan to take to address the recommendations. However, we will continue to monitor and evaluate WHD's efforts before the findings and recommendations can be closed. A complete copy of the response is attached.

BACKGROUND

The Fair Labor Standards Act (FLSA), enacted in 1938, established fair labor standards for the employment of workers in industries engaged in interstate commerce. One of the provisions of the FLSA was the establishment of a special minimum wage for workers with disabilities. Section 14(c) of the FLSA provides for the payment of wages below the Federal minimum wage to workers with disabilities, to prevent the curtailment of employment opportunities.

Section 14(c) also allows the Secretary of Labor, by regulation or order, to provide for the employment of individuals whose earnings or productive capacities are impaired by age, physical/mental deficiency, or injury. Such employment is authorized by the Wage and Hour Division (WHD) through the issuance of special certificates that permit wages that are:

- lower than the applicable minimum wage;
- commensurate with those paid to experienced workers without disabilities employed in the vicinity in which the individuals under the certificates are employed for essentially the same type, quality and quantity of work; and
- related to the workers' productivity.

The Secretary of Labor delegated the authority to issue special certificates to the Wage and Hour Division of the Employment Standards Administration. The Secretary of Labor issued regulations implementing Section 14(c) requirements at 29 CFR Part 525. Section 14(c) of the FLSA was last revised in 1986.

The special minimum wage rate (called the "commensurate wage rate") is based on the prevailing wage rate, which is adjusted according to the productivity of the worker with a disability as compared to the productivity of an experienced worker without a disability performing essentially the same type, quantity and quality of work in the vicinity in which the individual under the certificate is employed.

The key elements in determining a commensurate wage rate are:

- the productivity a worker without a disability, which is the objective gauge against which the productivity of the worker with a disability is measured,
- the prevailing wage, which is the wage paid to experienced workers who are not disabled for the same or similar work and who are performing such work in the area, and
- the productivity of the worker with the disability.

Workers may be paid a commensurate wage based on either an hourly rate or piece rate. Hourly rates are usually paid when products are not produced or where the type of work does not lend itself to the timestudies needed to determine piece rates. Hourly rates are most common for service jobs whereas piece rates are more common in manufacturing or assembly jobs.

For Section 14(c) eligibility purposes, a worker with a disability is defined as an individual whose earnings or productive capacity **for the work to be performed** is impaired by a physical or mental disability including those relating to age or injury. Disabilities which may affect earnings or productive capacities include blindness, mental illness, mental retardation, cerebral palsy, alcoholism and drug addiction. Furthermore, a disability which may affect earnings or productive capacity for one type of work may not affect such capacity for another. For example, an individual with a hearing impairment would not be considered disabled for the work performed, such as stocking groceries, without evidence that the hearing impairment affected the individual's ability to stock grocery shelves.

The WHD Midwest Regional Office in Chicago operates the Special Minimum Wage (SMW) program. Certification operations were consolidated in the Midwest Regional Office in 1996. Prior to 1996, each WHD Regional Office issued certifications and conducted Section 14(c) investigations. Today, the Midwest Regional Office conducts compliance reviews of certificate applications before issuing certifications.

The WHD classifies certificate holders by type of employer and issues certificates which vary in length of time, depending on the type of employer. Business establishments receive annual certification reviews, while hospitals/institutions and Community Rehabilitation Programs (CRP's) or "sheltered workshops" receive certification reviews every 2 years. Most Section 14(c) employers have participated in the program for a number of years, with few new employers joining the program.

The majority of employers operating under Section 14(c) certificates are nonprofit organizations called CRPs which provide employment opportunities to individuals with disabilities. Also participating in the program are private or public sector hospitals and institutions, that provide employment to institutionalized individuals. In addition, private sector business establishments, public sector employers and schools participate in the program. In Calendar Year 1999, WHD reported 8,580 certificate holders employing 425,579 employees.

Since the enactment of the FLSA in 1938, educational and employment opportunities for people with disabilities have increased dramatically. Programs and services are now available which provide people with disabilities increased access to employment and training programs. For example, the recently passed Workforce Investment Act (WIA) established "one-stop" delivery systems through which core employment-related services are now provided to all job seekers. In addition, the Ticket to Work and Work Incentives Improvement Act of 1999 (TWWIIA) will remove barriers that have made it difficult for individuals with disabilities to work and retain Social Security health care coverage. The TWWIIA to be phased in over a 3-year period beginning January 1, 2001, will provide Social Security and

Supplemental Security Income (SSI) disability beneficiaries a “ticket” which will be used to obtain employment services.

Finally, the House and Senate recently authorized the funding of a new DOL office dedicated to addressing the workplace barriers faced by adults with disabilities by improving access to employment services. The Office of Disability Employment Policy will begin operations in FY 2001.

AUDIT OBJECTIVES

Our overall objectives were to determine how effectively WHD managed the Special Minimum Wage (SMW) program and whether WHD and employers operating under the SMW program are partnering with other DOL, Federal, state and local program operators to improve employment opportunities for people with disabilities.

Our subobjectives were to determine whether:

- # WHD's enforcement efforts were adequate to ensure employer compliance with Section 14(c) of the Fair Labor Standards Act (FLSA),
- # employers were complying with the requirements of Section 14(c) of the FLSA,
- # employees were receiving the correct commensurate wage,
- # current methods used to measure worker productivity and determine prevailing wages were reasonable and proper, and
- # the Workforce Investment Act (WIA) and the Ticket to Work and the Work Incentives Improvement Act (TWWIIA) could be tapped to benefit the 14(c) program, and how WHD can assist program operators with utilizing the services of "one-stop" centers and other employment and training service providers.

SCOPE AND METHODOLOGY

We conducted a performance audit to evaluate WHD's administration of the Special Minimum Wage (SMW) program and review the extent to which employers are following the Section 14(c) of the FLSA. The audit period was Calendar Year (CY) 1999. However, we also verified changes in program management WHD made through December 2000.

We conducted fieldwork in WHD's Midwest Regional Office and at 10 certificate holders that paid workers commensurate wages during CY 1999. We selected a judgmental sample of 10 sites based on the types of certificates, disabilities and employers.

SITES VISITED			
Type of Certificates	Type of Employers	Location of Employers	Type of Disabilities
Community Rehabilitation Program	Thrift Store Small Assembly Business Vocational Rehabilitation Center Mental Health Facility Rehabilitation Center	Ohio North Carolina Florida District of Columbia Indiana	Alcoholism Developmental General Mental Illness General
Hospital/Institution	Residential Care Institution State Institution	Illinois Florida	Mental Illness Developmental
Business Establishment	Turkey Processing Plant Suburban High School Motel	Texas/Iowa Illinois Illinois	Mental Retardation General Autism

In evaluating the SMW program, we interviewed the SMW staff, certificate holders and employees who received commensurate wages during CY 1999. We reviewed documents relating to the payment of commensurate wages and information on program operations. Our objectives focused on evaluating the effectiveness of WHD's administration of the Section 14(c) program. The actual enforcement of employers' compliance with the FLSA is the responsibility of the WHD.

Our audit was performed in accordance with generally accepted auditing standards and the *Government Auditing Standards* for performance audits issued by the Comptroller General of the United States. Audit fieldwork started October 2000 and was completed February 2001.

CRITERIA

The principal criteria used to plan and perform the audit assignment was Section 14(c) of the Fair Labor Standards Act of 1938, as amended.

Other criteria include:

- # 29 CFR, Part 525-Employment of Workers With Disabilities Under Special Certificates
- # 29 CFR, Part 531- Wage Payments Under the Fair Labor Standards Act of 1938, as Amended
- # Chapter 64 of WHD Field Operations Handbook
- # The Workforce Investment Act of 1998
- # The Ticket to Work and Work Incentives Improvement Act of 1999

FINDINGS AND RECOMMENDATIONS

I. What Were the Key Issues Associated With Administering the Special Minimum Wage Program?

Our audit of the SMW program disclosed several factors that impacted WHD's ability to administer the certification program effectively and efficiently. WHD continues to experience some of those same problems. Specifically, we noted that WHD: 1) gave Section 14(c) low priority; 2) had an unreliable management information system (MIS); and 3) has a policy that provided for the assessments of minute amounts in back wages.

A. Low Priority Was Given to the SMW Program by the Wage and Hour Division

Initiatives, resources and goals for the SMW program indicated that the SMW program was given low priority by WHD in 1999. For example, the Employment Standards Administration's (ESA) Annual Performance Plan for Fiscal Year 2000 (which includes 1999 time frames) did not address goals or initiatives relating to the SMW program.

Also, ESA's 2000 Annual Performance Plan discussed the newly implemented Wage and Hour Investigative Support and Reporting Database (WHISARD) system. This new system allowed direct input of back wage assessments and could have benefited the SMW program. However, the SMW program was not given access to the WHISARD system and continued to operate on a manually batched and mail-in system until FY 2001.

The WHD's allocation of only six staff members to administer the SMW program nationwide was also indicative of the low priority afforded this program. Because the SMW program only had a staff of six, their efforts were limited to processing applications with minimal time available for monitoring or providing technical assistance, which is an integral part of running an effective program.

We also found that WHD did not have a requirement for the district offices to target SMW certificate holders for routine investigations. Consequently, few district offices conducted planned investigations. Our analysis of CY 1999 investigations found that 42 planned investigations were completed on employers holding SMW certificates.

Finally, much of the material in Chapter 64 of WHD's FOH covering the SMW program was outdated. Although WHD amended one section of Chapter 64 in March 1987, all of the other sections predated the 1986 amendments to the Act. For example, the section which addressed alcoholism, had criteria for organizations to pay alcoholics a uniform certificate rate of 50 percent of the minimum wages during a learning period. The 1986 amendments to the FLSA superseded the FOH provision allowing organizations to pay alcoholics a uniform rate.

B. The Management Information System Was Unreliable for Reporting Program Results

The MIS used by WHD provided unreliable data. The SMW certificate database could not be used as a reliable tool to validate the annual statistical data reported to Congress. Additionally, the information in the Certification Processing System (CPS) database was inaccurate and back wages assessed under Section 14(c) of the FLSA during WHD compliance review process were underreported.

Annual Statistical Data Could Not Be Validated

Historically, under Section 4(d) of the FLSA, WHD submitted an annual report of its activities to Congress. For FY 1999, WHD reported 8,580 employer certificates were issued for the SMW program covering “sheltered workshops,” “handicapped workers” and “patient workers.” However, WHD informed us that although the report states certificates “issued” during FY 1999, WHD actually reported the total certificates in effect for FY 1999.

To validate this information, we requested copies of WHD’s database that generated the reported statistics. We were initially given an SMW program “Alpha-4” database, which contained only 4,804 certificates. This represented **56 percent less than** the total number of certificates reported. We were subsequently given an updated database, which consolidated the information in the Alpha-4 system with the CPS. However, this system showed 12,719 certificates were issued, which is **48 percent more than** the original number of certificates reported.

We found that the reported 8,580 certificates could not be verified using the consolidated database because the system lacked the capability to capture or retrieve a “snapshot” of the reported activities. The system is continuously updated and reports showing FY 1999 statistics were not maintained and could not be regenerated. Furthermore, our analysis of the consolidated database disclosed additional deficiencies that impacted its accuracy. For example, we found 1,546 certificates with effective dates in 2099. On many occasions the 2099 data duplicated the 1999 information. Also, we found that the database contained over 5,000 expired certificates dating as far back as 1995.

Statistical information is used by Congress and other organizations to evaluate the activities of Section 14(c). If statistics are to be usable, they have to be accurate and supportable. WHD needs to ensure that its automated system has the ability to duplicate any statistics it reports.

Information in the Certification Processing System Database was Inaccurate

Our review of the CPS database noted that the number of workers recorded as employed under SMW certificates was inaccurate. We compared the information in the database to the applications submitted by 5 of the 10 sites we visited. We found inaccuracies in three of the five employer certificates we examined. In two instances the employers had grossly overestimated the number of workers employed under their Section 14(c) program. In another instance, WHD inaccurately entered the reported information into the CPS database.

One employer we visited reported 740 workers with disabilities covered under its certificate which should have been only 243. The employer was reporting the total number of workers with disabilities regardless of whether they were covered under the certificate. This employer also reported figures from the prior year instead of the period covered by the certificate.

Another employer had two certificates that fell within our review period and both certificates were overstated. The employer reported that it had 37 workers with disabilities on one certificate and 48 on the other. However, our review disclosed that the numbers should have been 9 and 11, respectively.

The one case in which the number of workers with disabilities was incorrectly entered by WHD involved 524 workers from a prior year application. The correct number was 297.

Since this information is relied upon by decision makers to evaluate the number of workers employed under SMW certificates, every effort should be made to verify its accuracy. Therefore, WHD should implement procedures to ensure the integrity of the data reported.

Back Wages Assessed During WHD Compliance Review Process Were Underreported

WHD's MIS system did not accurately report all back wages assessed through the compliance review process. As a result, WHD under reported \$151,709 in back wage assessments for CY 1999.

The SMW staff did not have access to the WHISARD system and, therefore, wage specialists were required to complete the necessary forms and mail the documentation to the appropriate district offices. The district offices were responsible for entering the data into the system.

We found that 46 percent of the back wages assessed through the compliance review process were never entered. The failure to account for the back wage assessments was caused by a lack of adequate control procedures to ensure data input and a lack of emphasis by the district offices to ensure that the Section 14(c) data were entered.

Because the back wage assessments were not entered, the SMW program was not fully recognized for its efforts, nor was management provided with a true picture of the extent of noncompliance under Section 14(c).

Beginning October 2000, WHD provided the SMW program on-line capabilities to input data. This on-line capability should reduce the risk of back wage assessments not being entered into the system.

C. WHD Policy Provided for Assessments of Negligible Amounts of Back Wages

WHD’s procedures require a compliance review of all applications received for SMW certificates. Among other things, Wage Analysts examine the applications and verify calculations used to determine if wages paid to workers with disabilities are commensurate with wages paid to nondisabled workers. When errors occur, employers can be assessed back wages.

Our review of WHD’s compliance review process revealed that back wages of negligible amounts (as low as \$0.01) for individual employees were sometimes assessed. The following table shows examples of average back wage assessments for 5 of the 486 employers assessed back wages in CY 1999:

Employer s	Total Back Wages Assessed	Number of Employees Affected	Average Assessments per Employee
1	\$43.37	59	\$.74
2	75.26	81	.93
3	71.14	66	1.08
4	62.91	39	1.61
5	211.32	113	1.87

The effort expended by WHD to monitor payments of the back wages and the time spent by employers to pay the small assessments are, in our opinion, not cost effective. Although we recognize the importance of wages to the population affected, we believe that prudent business practices necessitate that consideration be given to the benefits received by the employees versus costs incurred by the employers.

WHD should take into account materiality when assessing back wages. WHD should be mindful that many of the organizations with Section 14(c) certificates are nonprofit entities. Excessive administrative costs that are incurred as a result of small back wage assessments could negatively affect the services the entities are able to provide.

II. Does the WHD's Application Certification Process Ensure Employer Compliance With Section 14(c) Requirements?

The majority of WHD's Special Minimum Wage (SMW) program resources are devoted to conducting compliance reviews of employer applications for Section 14(c) certificates. The purpose of the compliance review is to ensure employers comply with Section 14(c) requirements and to assess back wages when workers are underpaid. We found the SMW program compliance review process offers little assurance that employers are complying with Section 14(c) requirements, particularly regarding the payment of correct commensurate wages.

During the compliance review process, WHD reviews the paperwork submitted by employers to support the commensurate wages paid. Most of the problems discovered during the WHD compliance reviews concerned the incorrect calculation of wage rates, incorrect rounding of numbers, or using entry level wages as prevailing wages. In Calendar Year 1999, WHD assessed employers back wages of \$327,499 as a result of compliance reviews.

A) Increased Monitoring and Technical Assistance Are Needed to Ensure Employer Compliance With Section 14(c) Requirements

In Calendar Year 1999, we found that WHD conducted no onsite monitoring and provided little technical assistance to all SMW certificate holders. Our review of selected employers found that despite the certification process, some employers were not fully complying with the SMW program requirements. Furthermore, employers generally assumed they were in compliance with program requirements simply because they had been issued certificates by WHD.

Three major steps must be taken by employers to determine the correct commensurate wage rate. Employers must: 1) determine the prevailing wage; 2) develop an objective standard termed, "work measurement methods," to measure productivity; and 3) apply the standard to evaluate the productivity of the employee with a disability.

The establishment of the prevailing wage is an important component in determining the commensurate wage rate paid to Section 14(c) employees because it is the basis upon which the wage is adjusted for the individual worker's lower productivity. The higher the prevailing wage, the higher the commensurate wage. Two main options are available to employers in determining the prevailing wage. The employer may use the wage of the firm's experienced worker without a disability as the prevailing wage, or survey employers in the surrounding community to determine the prevailing wage of experienced workers doing the same or similar types of jobs. The Section 14(c) regulations call for a representative sample of employers, usually with at least three employers.

In addition to determining the prevailing wage, the employer must develop an objective standard to measure the productivity of the worker with a disability. After the objective standard is developed, the

productivity of the worker with the disability must be evaluated to determine how much the worker will be paid.

We found numerous problems in the methods used to determine commensurate wages for 4 of the 10 employers visited. We found instances where objective standards were not developed or where worker individual productivity was not measured. We also noted instances where prevailing wages were incorrectly determined by employers to be close to or at the minimum wage.

The four employers with material problems included: a private-sector employer; a private-sector residential care institution; a public high school; and a faith-based organization. A detailed discussion of each employer follows:

1) **Processing Plant Workers**

We visited a private-sector employer that employed migrant workers with mental retardation at a turkey processing plant. Approximately 50 workers performed a variety of entry-level jobs at the plant under Section 14(c). The employer also operates a group home near the plant where workers receive cash, meals, lodging and other services, which includes supervision, transportation, entertainment and other assistance.

The employer's 1999 certification renewal application to WHD reported average earnings of \$5.65 per hour for turkey processing plant workers. To arrive at \$5.65, the employer totaled all yearly expenses related to the employment of the workers with disabilities, then divided total expenses by the total number of hours worked during the year (\$560,885 divided by 99,243 hours = \$5.65 per hour). The **actual** compensation each Section 14(c) worker received was between \$60 and \$65 per month in cash, plus meals, lodging and other services.

The company valued the cash, plus meals, lodging and other services each worker received at \$864 per month per person. All expenses directly and indirectly related to the employment of the workers were included in the methodology used to determine the value of noncash compensation. In our opinion, these expenses included costs that would not be allowed under the FLSA.

Expenses used to determine the value of the noncash compensation included \$67,200 per year for the use of the group home where the Section 14(c) workers lived. The group home is owned by a city located near the processing plant. The company pays the city \$600 per month in rent for use of the facility. The additional \$60,000 per year represents what the employer considered the "fair value" for recouping the costs of the improvements made to the city-owned property during the 1970s.

Other expenses included approximately \$100,000 for the cost of building supplies for the construction of a retirement home. The salaries of the two company owners also were included in determining the value of the noncash compensation Section 14(c) workers received. One of the owners ran a ranching operation and was not directly involved in the turkey processing operation. The other owner

supervised turkey processing operations and provided custodial care services to the migrant workers living in the group home.

The FLSA permits an employer, under special conditions, to include in its wage obligation, the “*reasonable cost*” to the employer of furnishing board, lodging and other facilities to its employees. The FLSA also authorizes the Secretary of Labor to determine the “*fair value*” of the board, lodging and other facilities, “*where applicable and pertinent.*”

Title 29, Part 531.2(a) of the Code of Federal Regulations (CFR), states,

. . . the Act defines the term “wage” to include the “reasonable cost”, as determined by the Secretary of Labor, to an employer of furnishing any employee with board, lodging, or other facilities, if such board, lodging, or other facilities are customarily furnished by the employer to his employees. . . .

In addition, Part 531.3(a) states,

The term “reasonable cost” . . . is hereby determined to be not more than the actual cost to the employer of the board, lodging, or other facilities customarily furnished by him to his employees.

Also, Part 531.3(c) states,

. . . the “reasonable cost” to the employer of furnishing the employee with board, lodging, or other facilities (including housing) is the cost of operation and maintenance. . . .

The commensurate wages in 1998, based on methodology developed after the 1997 WHD review, varied from \$4.03 to \$5.72 per hour. However, the commensurate wages were not the wages paid to the employees. The commensurate wage was used to calculate overtime payments only.

WHD, after conducting the 1999 compliance application review, did not question the employer’s reporting average wages of \$5.65 per hour or the method used to calculate noncash wage payments. We were told by WHD that some employers, who pay more than the minimum wage of \$5.15 will continue to renew their certificates because the certificates allow payment of special minimum wages. If the employer once again hires workers at less than the minimum wage, a current certificate will allow them to do so. Without actually performing an onsite review of the employer’s operation and the methodology used to determine noncash payments, WHD would not be aware the employer paid workers less than the \$5.65 per hour reported.

The current method to account for noncash compensation was established, according to one of the company’s owners, after WHD conducted an onsite review approximately 40 years ago. All expenses

directly or indirectly related to employment of workers with disabilities are considered “program expenses” and included in the noncash payment calculation. However, only the “reasonable cost” of providing workers with meals, lodging and services are allowed. The company’s accounting practice of including in the commensurate wage computation such items as property improvements, building supplies, and owner salary expenses unrelated to the operation of the group home, appears questionable.

2) **Institutionalized Patient Workers**

We visited a private-sector residential care institution which serves individuals with severe mental illness (most patients were diagnosed with schizophrenia). Patients enter the institution after hospitalization or after attempts to live at home or in the community have failed. Most of the patients lived at the institution for a number of years and will remain in the institution or in another institutional setting for the rest of their lives. Of approximately 180 patients who resided at the facility in 1999, 63 were employed under the Section 14(c) certificate.

The institution provides patients with part-time, in-house employment, which serves to keep the patients occupied, help build self-esteem and provides needed spending money for clothing, sodas, cigarettes and other items. In 1999, the most productive patients received a salary of \$75 per month washing dishes. The least productive patients performed what the institution called “courtesy work,” such as filing papers and picking up mail. The time spent on courtesy work was minimal, generally less than one hour per day. Courtesy workers received a flat rate of \$10 per month for the performance of their duties.

The patients were paid a salary for the various jobs performed, and the salary amount was determined by what the institution considered a reasonable value for the work performed. For example, most kitchen workers received a salary of \$75 per month and worked up to 20 hours per week. Kitchen workers were paid a salary instead of an hourly rate because it was difficult to account for the time each individual worked. If kitchen workers arrived late, or were unable to work because of their illnesses, they were still paid a salary of \$75 per month.

In 1998, WHD conducted a review of the institution’s application for renewal. As part of the application package, WHD requires the attachment of three individual productivity studies. The productivity studies were not attached and WHD contacted the employer and requested the studies. The institution completed the studies, submitted the information to WHD and a certificate was issued. However, the individual productivity studies were not honored by the employer because the studies required paying average wages equaling \$2 per hour, which was higher than the \$1 to \$1.25 per hour the institution traditionally paid. The productivity studies were submitted simply to meet the WHD requirement, not to determine and pay the commensurate wage.

No individual productivity studies were completed in 1999 for the 63 workers who were supposed to receive commensurate wages. In addition, the standards for each job classification (based on the productivity of an experienced worker without a disability) were not completed.

Title 29, Part 525.9 (3) of the CFR, requires the measurement of the productivity of “. . . workers with disabilities compared to the norm established for nondisabled workers through the use of a verifiable work measurement method. . . .”

Also, Part 525.12(j) (3) of the CFR states,

Upon completion of not more than six months of employment, a review shall be made with respect to the quantity and quality of work of each hourly-rated worker with a disability as compared to that of nondisabled workers engaged in similar work or work requiring similar skills and the findings shall be recorded. The worker's productivity shall then be reviewed and the findings recorded at least every 6 months thereafter. . . .

In 2000, a consultant hired by the institution with knowledge of Section 14(c) regulations, completed productivity studies for most of the Section 14(c) workers. Individual productivity studies were not completed for “courtesy workers” because of the difficulty the consultant had in attempting to measure productivity. For example, a productivity study was not completed for the individual who picked up the mail because the consultant could not figure out a way that would adequately measure the patient’s productivity.

In addition, the institution was not using the correct prevailing wage to determine the commensurate wage. The institution used the wage it would pay an entry level person as the prevailing wage. The institution has very little staff turnover and the wages of experienced workers are significantly higher than the entry level wage.

Title 29, 525.10 (b) of the CFR states,

An employer whose work force primarily consists of nondisabled workers or who employs more than a token number of nondisabled workers doing similar work may use as the prevailing wage the wage rate paid to that employer's experienced nondisabled employees performing similar work. Where an agency places a worker or workers with disabilities on the premises of an employer described above, the wage paid to the employer's experienced workers may be used as prevailing.

The FLSA requires the payment of wages to employees when an employer/employee relationship exists. The FLSA offers a broad definition of what constitutes an employer/employee relationship. In FLSA, Section 3 under definitions, “employee” means any individual employed by an employer and “employ” means to suffer or permit to work.

The regulations offer guidance on determining if an employer/employee relationship exists in institutions. Title 29, Part 525.4 of the CFR states,

With respect to patient workers . . . a major factor in determining if an employment relationship exists is whether the work performed is of any consequential economic benefit to the institution. Generally, work shall be considered to be of consequential economic benefit if it is of the type that workers without disabilities normally perform, in whole or in part in the institution or elsewhere. . . .

The institution's management believed the patient worker program to be of little economic benefit to the institution. Rather, the program serves to improve the patients' quality of life by providing the patients with activities in which to spend their time. Also, patients have little cash income. Supplemental Security Income (SSI) limits cash payments to patients of \$30 per month for spending money. The SSI payments, along with the wage payments, are often the only income available to the patients.

The institution has never received an onsite WHD review. With an onsite review, WHD could provide technical assistance and review the employer/employee relationship to determine whether all patient workers need to be classified as employees and are covered under Section 14(c) of the FLSA. In addition, assistance could be provided on how to develop the correct prevailing wage if the employer was found to be covered under Section 14(c).

3) High School Student Workers

We visited a public high school which employs students with a variety of disabilities, including mental retardation and learning disabilities. The students participate in the school's special education work training program where they work between 8 and 12 hours per week. In 1999, 28 students participated in the program. All Section 14(c) workers performed a variety of tasks in the office, cafeteria and maintenance department. In addition, students in the workshop packaged and boxed items for local businesses.

The purpose of the work program is to prepare the students for transition to work after leaving high school. Students may remain in the school's special education work training program until they are 21 years of age. We were told by school officials that many of the students will most likely be placed in community rehabilitation program workshops after graduation.

The students started at a fixed rate of \$2.50. All received the same starting pay, which was not related to the student's productivity. The school officials believed the fixed rate was reasonable based on the student's skill levels. The money acts as an incentive to encourage the students to learn and not to compensate the students for the work performed.

The individual student productivity studies and standards for each job classification were not completed. Instead, students received evaluations, completed by the immediate supervisor, which

rated the students on various job skills. The students' individual productivity for the various jobs performed was not measured.

The objective determination of each student's productivity is a requirement under Title 29, Part 525.9 (3) of the CFR, which requires the measurement of the productivity of “. . . *workers with disabilities compared to the norm established for nondisabled workers through the use of a verifiable work measurement method. . . .*”

In addition, the school used the minimum wage as the prevailing wage. The high school listed \$5.15 on the certificate application to WHD. Although it is possible for the minimum wage to also be the wage paid an experienced worker, a prevailing wage listed at \$5.15 is an indication the employer is not aware of Section 14(c) requirements and should have elicited a phone call by WHD to provide technical assistance.

We observed the students working and their productivity appeared very low. However, without a verifiable method of determining the students' productivity, and the establishment of the correct prevailing wages, an objective determination of whether the students received the correct wages cannot be made. The school, participating in the Section 14(c) program since the late 1980s, has never received an onsite WHD review.

4) Thrift Store Workers

We visited a faith-based program that provided employment, meal, lodging and counseling to alcoholics. The alcoholics were employed as truck drivers, driver helpers, and balers, and worked in the organization's thrift store operations. In addition, participants were employed as kitchen and janitorial workers in the organization's living and dining quarters.

In 1999, 133 employees received commensurate wages. Most workers reviewed started at a commensurate wage of \$2.58, which was 50 percent of the prevailing wage. The workers then received pay raises of 25 cents per week until they were paid slightly higher than the minimum wage. The wage increases were paid as long as the workers remained sober, and made progress in overcoming their addiction to alcohol. If a worker started drinking, the worker was dismissed from the program, then readmitted after becoming alcohol free. After being readmitted, the worker would start again at half the prevailing wage and work back up the pay scale.

The commensurate wage rate paid to the workers was not based on their individual productivity. The organization did not observe the productivity of a worker without a disability and develop a standard with which to measure the Section 14(c) workers productivity. The workers received quarterly performance evaluations, and copies of the evaluations were submitted to WHD during the certification application renewal process. However, the performance evaluations did not measure the workers' productivity. The evaluations measured the Section 14(c) workers' progress in overcoming their addiction to alcohol.

Title 29, Part 525.9 (3) of the CFR, requires the measurement of the productivity of “. . . workers with disabilities compared to the norm established for nondisabled workers through the use of a verifiable work measurement method. . . .”

An objective standard was not developed to measure the productivity of Section 14(c) workers because the organization did not believe alcoholism affected the workers’ productivity. Recovering alcoholic truck drivers, for example, performed the same duties as truck drivers without alcoholism and were just as productive. The problem the Section 14(c) workers faced was being removed from the program if they once again started drinking. Starting the Section 14(c) workers at less than the minimum wage, and offering periodic pay increases, acted as an incentive to keep the participants sober.

The practice of starting all workers at the same pay rate has a historical origin. Prior to the revision of the FLSA in 1986, employers who hired workers in an alcohol rehabilitation program were allowed to pay a fixed rate below the minimum wage. The WHD FOH dated May 7, 1984, allowed the payment of half the “shop rate” or minimum wage to truck drivers during a learning period. However, the current Section 14(c) regulation requires the employers to either show how the disability impacts individual productivity or pay the minimum wage.

In addition, the thrift store employer was not using the correct prevailing wage to determine the wages paid. The employer based the prevailing wage on what an entry level position worker would make at the firms contacted. Title 29, Part 525.10 (d) of the CFR states,

The prevailing wage rate must be based upon the wage rate paid to experienced nondisabled workers. . . .

Also, the employer reported to WHD that it surveyed one to two employers for each job classification, instead of the minimum of three employers as required to determine the prevailing wage for each job classification.

Title 29, Part 525.10(c) of the CFR states,

An employer whose work force primarily consists of workers disabled for the work to be performed may determine the prevailing wage by ascertaining the wage rates paid to the experienced nondisabled workers of other employers in the vicinity. Such data may be obtained by surveying comparable firms in the area that employ primarily nondisabled workers doing similar work. The firms surveyed must be representative of comparable firms in terms of wages paid to experienced workers doing similar work. The appropriate size of such a sample will depend on the number of firms doing similar work but should include no less than three firms unless there are fewer firms doing such work in the area. . . .

In 2000, the employer made changes to program operations. A staff person was hired to address the clinical aspects of alcohol dependency. In addition, individuals admitted, or readmitted, are not allowed to earn wages for 90 days. During this period, participants receive counseling and perform chores around their living quarters.

The employer is now obtaining several sources to determine prevailing wages. After the latest WHD compliance review of the employer’s application for certificate renewal, the employer was instructed to obtain prevailing wage information from several sources and the employer followed WHD instructions. However, the organization continues to use entry level positions to determine the prevailing wages, and start workers at half the prevailing wage rate based on subjective criteria.

B. Adequate Monitoring and Technical Assistance May Increase Employer Compliance and Reduce the Need to Assess and Collect Back Wages

We reviewed the type and number of violations cited by WHD during the compliance review process in CY 1999. Our review of the most frequent occurrences in 486 recorded violations disclosed the following:

Violations	Number of Occurrences
Piece rate rounded incorrectly	116
Prevailing wages incorrect	69
Hourly wage rate computed incorrectly	37
Quality factor not used in hourly rate evaluation	24
Entry-level prevailing wage	22
Piece rate calculated incorrectly	22

Many of the violations listed above were minor in nature and in our opinion could be avoided by providing employers with written guidance, technical assistance and monitoring reviews. For example, providing SMW certificate holders with written guidance would address which method WHD finds acceptable when rounding piece rate calculations. We found numerous instances where employers rounded piece rate calculations to **two and three decimals** while WHD rounded up to **seven decimals**. These different rounding methods resulted in back wage assessments. In addition, the methods used by employers to determine prevailing wages resulted in numerous violations. The WHD may lower the number of violations by informing employers that prevailing wages must be based on the rate paid experienced workers.

Assessments of Back Wages Increased Significantly in 2000

Assessments of back wages from compliance reviews increased significantly in CY 2000. In 1999, back wage assessments totaled approximately \$327,000. In 2000, back wage assessments totaled approximately \$798,000. Where possible, we believe a more proactive approach to prevent employers misunderstanding is better than a reactive back wage assessment.

In 2000, WHD placed greater emphasis on ensuring certificate applications contained all the necessary information. For example, applications which contained evidence of less than three sources for the prevailing wage survey were returned to employers for action. The increased attention to finding problems after-the-fact during the compliance review process, in our opinion, will continue to increase back wage assessments. Alternatively, the proactive provisions of technical assistance and onsite monitoring reviews would be expected to increase employer understanding of program requirements, in turn increasing compliance and reducing the need to assess back wages.

Although we support the active enforcement of Section 14(c) regulations, we believe a combination of factors resulted in employer noncompliance and these factors must be addressed. Several of the employers we visited have operated out of compliance for a number of years and reviewing certificate applications alone did not discover all noncompliance problems.

Conclusion

The WHD management of the SMW program offers little assurance that employers are complying with program requirements. Numerous problems were noted with employers who either did not understand or were not following Section 14(c) requirements when determining commensurate wages paid to their employees. Furthermore, employers generally assumed they were in compliance with program requirements simply because they had been issued certificates by WHD.

The technical assistance provided to employers by WHD was limited to providing information during the compliance review process. At most sites visited, employers stated that communication between them and WHD was minimal, and they would like WHD to be more proactive in providing information on program requirements. Conducting onsite monitoring and compliance reviews and providing employers with technical assistance will help ensure employer compliance with critical Section 14(c) requirements.

III. How Can the Special Minimum Wage Program Improve Employment Opportunities for Workers With Disabilities?

Employment policy related to the employment of workers with disabilities has changed since the enactment of the FLSA in 1938. With the passage of the Rehabilitation Act of 1973, the Americans with Disabilities Act of 1990 (ADA), and the Workforce Investment Act of 1998 (WIA), educational and employment opportunities for people with disabilities have increased dramatically. In addition, the Ticket to Work and Work Incentives Improvement Act of 1999 (TWWIA), when fully implemented, will remove barriers that have made it difficult for individuals with disabilities to work and retain Social Security health care coverage. Also, the DOL, through workforce development efforts, has placed increased emphasis on improving employment opportunities for workers with disabilities.

The WHD, by becoming more involved in DOL's workforce development efforts, could assist Section 14(c) employers in improving employment opportunities for workers with disabilities. We found employers were often not aware of DOL programs and services available to them. For example, only one of the employers visited was utilizing DOL programs and services to increase employment opportunities for Section 14(c) workers.

We visited a CRP providing training services to individuals with autism, which is an example of the type of CRP that could benefit from DOL programs and services. The CRP referred workers to one of the business establishments we reviewed and assisted the employer in completing the paperwork related to employing workers under Section 14(c). The CRP was not aware that the local "one-stop" could assist the CRP in contacting employers looking to hire workers. Under the WIA, local workforce investment boards established "one-stop" delivery systems through which core employment-related services are provided. The "one-stop" services could be used by the CRP to increase employment opportunities.

Also, we visited a CRP employing workers with mental illnesses who may benefit from TWWIA. The CRP operated an employment and training program to get participants "ready for work" in competitive employment. The major barrier to employment was the loss of the "social safety net," specifically, medical insurance and Social Security payments. The loss of Social Security medical insurance is a major problem for the CRP workers seeking competitive employment. The TWWIA to be phased in over a 3 year period beginning January 1, 2001, will provide Social Security and SSI disability beneficiaries a "ticket" which will be used to obtain employment services. The WHD could assist the implementation of the TWWIA by working with Social Security officials and providing Section 14(c) employers information on how TWWIA may benefit them and their employees.

Several of the employers we visited, with few resources available to them, were doing an excellent job at providing employment and training to individuals with disabilities. The WHD could assist employers by working with other DOL and government agencies to provide employers with information on programs and services available under the WIA and other programs offering services to workers with disabilities.

The House and Senate recently authorized the funding of a new DOL office dedicated to addressing the workplace barriers faced by adults with disabilities by improving access to employment services. The Office of Disability Employment Policy will begin operations in FY 2001. The OIG encourages WHD to work with the new office and other DOL agencies involved in the employment and training of people with disabilities. The WHD, by becoming more involved in workforce development efforts, could assist Section 14(c) employers and employees in taking advantage of services now available to them.

Conclusion

During our audit period, WHD started taking steps to improve the management of the SMW program. The WHD improved Midwest Regional Office operations by adding a new manager to direct program operations. Increased emphasis has been placed on ensuring applications sent by employers are correctly completed and contain all the required information. Also, steps were taken to improve the management information system used to track certificates and report on program statistics. Finally, the FOH is being updated and training seminars for program participants are being planned or conducted.

In addition, WHD plans to increase staff training and education and outreach activities. For example, WHD Midwest Region developed initiatives to be implemented in FY 2001 including increased compliance reviews, employers' educational assistance, establishing partnerships with advocacy groups, determining a method to measure customer satisfaction, and increased training of Section 14(c) team members.

We commend WHD for its efforts. However, improvements are still needed in the areas of program management, strategic planning, monitoring, technical assistance, and partnering. For example, database management deficiencies still need to be addressed, the updated FOH needs to be issued, increased technical assistance and onsite reviews must be included in ESA's strategic planning process.

It has been a number of years since WHD has had in place a mechanism to solicit recommendations from employers, employees and advocates, and other interested parties on needed program guidance and legislative changes. An Advisory Committee, or other methods devised by WHD, could be used to solicit recommendations from interested parties on needed program reforms. Moreover, by becoming more involved in DOL's workforce development efforts through partnering, WHD could assist Section 14(c) employers and employees in taking advantage of DOL and other government services now available to them.

Recommendations

We recommend the Assistant Secretary for the Employment Standards Administration (ESA):

- 1) Include in ESA's strategic planning process a program for increased Section 14(c) onsite monitoring and enforcement.
- 2) Develop an "action plan" to improve WHD's Section 14(c) program management operations by:
 - correcting database management inaccuracies and deficiencies,
 - ensuring that all statistical reports can be supported and validated,
 - implementing controls to ensure the integrity of data entered into the MIS (i.e., through the use of statistical sampling methods),
 - issuing updated policies and procedures, and
 - developing a policy that assesses employers for only material amounts of back wages.
- 3) Increase technical assistance to Section 14(c) employers by:
 - providing employers with written guidance on Section 14(c) requirements, and
 - engaging organizations, or individuals, with knowledge of Section 14(c) requirements to provide technical assistance to employers.
- 4) Establish an Advisory Committee, or consider other methods to solicit recommendations from government officials, employers, employees and advocates, on needed program guidance and legislative reforms.
- 5) Establish partnerships with DOL's Employment and Training Administration, the Office of Disability Employment Policy, and other government agencies involved in the employment and training of people with disabilities.

Agency's Response

For recommendation number 1, WHD responded that the FY 2001 strategic plan for the Northeast Region requires each of its 14 district offices to conduct investigations on a minimum of five Section 14(c) employers. Several district offices located within other regions have scheduled their own local enforcement or technical assistance initiatives involving Section 14(c). WHD indicated that it will closely examine the findings of the FY 2001 Section 14(c) initiatives to determine future strategy for improving administration of Section 14(c) program.

For recommendation number 2, WHD responded that its Section 14(c) Committee met in February 2000 to evaluate the Section 14(c) compliance program, make recommendations for improvements,

establish goals, and develop strategies for realizing those goals. In October 2000, the Committee provided WHD management a draft action plan with all actions to be completed by the end of FY 2001. The Committee will meet again in April to review the plan, make recommendations to be considered for the FY 2001 strategic plan and evaluate the current policy of collecting all back wages found due workers with disabilities without regard to the size of the underpayments.

WHD also responded that it is correcting database inaccuracies, working to standardize the reporting capabilities of the CPS and, revising its application form to make it easier for employers to complete. Additionally, WHD responded that steps have been taken to update and issue policies and procedures for the administration and enforcement of the Section 14(c) program. WHD stated that these efforts should result in more accurate data input and increase the integrity and accuracy of the data validity of the reports issued.

For recommendation number 3, WHD responded that a fact sheet on the fundamentals of Section 14(c) was developed and placed on the WHD's Homepage, a PowerPoint presentation has been distributed in both electronic and paper formats, and WHD has received commitment from the Office of the Assistant Secretary for Policy to create an "elaw" module on Section 14(c), by the end of FY 2001. WHD will also create and maintain a "Section 14(c) Homepage" to provide the public with an overview of the program and links to related sites. Finally, WHD provides written information and policy updates with renewal applications and new certificates sent to employers.

Furthermore, WHD responded that it has established a partnership with organizations and individuals that work with or on behalf of workers with disabilities to provide employers with technical assistance. Additionally, the new Regional Section 14 Team Leaders are also cultivating similar partnerships with similar State and Local organizations.

For recommendation number 4, WHD responded that it actively solicits and receives recommendations and comments from government officials, employers, employees and advocates in several forums. The partnerships established with government and nongovernment organizations provide avenues of communication, facilitate the exchange of ideas and foster an environment of innovation. WHD conducts meetings with stakeholders who have an interest in issues related to the employment of people with disabilities.

For recommendation number 5, WHD responded that it is working with the Office of Disability Employment Policy, providing input on their proposed grant announcement. WHD will continue its working relationship with ETA and will ensure that information regarding labor standards administered by WHD, including Section 14(c), is available at the One-Stop centers.

WHD is partnering with representatives of the SSA to provide literature and training to interested parties, and working with State partners so they are aware of the employment options available to workers with disabilities and organizations that employ them. Finally, WHD investigators will

disseminate publications prepared by other government agencies that address the employment of workers with disabilities.

The agency's complete response is included as an Appendix to this report.

Auditor's Conclusion

We concur with the agency's ongoing and planned actions, and believe these actions are sufficient to resolve all recommendations. However, we are unable to close these recommendations until we receive evidence supporting the actions taken.

Specifically, we need to receive the following:

- < the agency's strategy for improvement once WHD has completed the investigations on Section 14(c) employers,
- < the Section 14 Committee draft action plan and completed items,
- < results of WHD's evaluation of its policy to collect all underpayments regardless of size,
- < copies of the revised Section 14(c) application form and the FOH when issued,
- < notice when the "elaw" module and the "Section 14(c) Homepage" is fully operational,
- < minutes or documentation from the stakeholder meeting that clearly show that all parties (i.e., advocates, employers of workers with disabilities) that have an interest in the Section 14(c) issues are represented, and
- < documentation that details WHD partnering efforts.

APPENDIX

AGENCY'S RESPONSE