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How to Conduct a Wage & Hour "Check Up"

BY KARA E. SHEA ON OCTOBER 15, 2014 ·

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One of the top areas of exposure for most employers is wage and hour law. In fact, employers are about three times more likely to be sued in federal court for violations of the Fair Labor Standards Act (FLSA), the federal law regulating wage issues, than they are for discrimination or harassment. At the same time, wage and hour enforcement agencies such as the U.S. Department of Labor (DOL) are also cracking down. Given the recent increase in wage and hour litigation and enforcement, employers should periodically conduct an internal review to spot and correct wage and hour compliance issues. I've assisted clients with numerous such self-audits through the years, and in doing so, I've come up with the following priority "checklist."

Independent contractor classification.

Your first step is to take a close look at any workers you've classified as independent contractors to make sure they meet the applicable criteria under the Internal Revenue Service (IRS) test and other tests. I put this item first on the list because, for purposes of the rest of your audit, you need to be sure which individuals are truly your "employees" for wage and hour compliance purposes, since the FLSA does not apply to true independent contractors, only to employees.

Make sure you have updated written agreements with any such workers which clearly define the relationship; however, you also should look closely at your organization's day-to-day interaction with these individuals, since contract language will not be determinative if the reality of the situation suggests an employment relationship. When conducting this review, the most important factors to look at are how much control or direction you have over the work of the contractor, and whether the contractor is truly economically independent from your organization. If you have misgivings on either of those issues, it is probably best to get some expert advice. If your organization has misclassified these workers, you may face a steep back tax bill, among other consequences, if you're audited.

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Exempt classification.

Next, look at any positions you've classified as exempt from the timekeeping and overtime requirements of the FLSA. For each position you have classified as exempt, you need to make sure you can explain, and support, your reasons for doing so. First, identify which exemption you believe applies to the position. Then, refresh yourself on the requirements for that exemption (the DOL website is good place to start:

<http://www.dol.gov/elaws/esa/flsa/screen75.asp>). Review the applicable exemption criteria and make sure you are comfortable with your classifications based on the compensation rates and job duties for each position. If you are using an exemption requiring a salaried basis of payment, make sure you are not making improper deductions from salary which might jeopardize the exemption. You should also review organizational charts, salary ranges, and job descriptions, in addition to talking with exempt employees and their supervisors. This will likely be the most time-consuming part of your self-audit and the part where the toughest judgment calls need to be made. Remember, it is the employer's burden to show why an exemption applies, so if you are in doubt, you may want to consider reclassification. Or at least you will want to make sure that whatever cost saving or other benefit derived from the exempt classification is worth the risk you are taking, since, if your workers are found to have been misclassified, you may have to pay back overtime up to three years in addition to liquidated damages and attorneys' fees if the matter goes to court.

1. For the next step, you can proceed to look at your non-exempt workforce. You will need to make sure your current timekeeping method is accurately capturing all work hours for employees you will continue to classify as nonexempt. Ensure that employees and supervisors understand your timekeeping system and are using it correctly. Make sure supervisors are not altering time records without approval or verification from the affected employees. Look for "red flags," such as time records that appear too uniform, or areas where overtime has suddenly vanished despite no new hiring and no dip in productivity.

Work time analysis.

This step is closely related to the previous step. To accurately record their hours, workers must understand what work time is, and so must you. Again, look closely at all activities to make sure all work time is being recorded and no work is being done "off the clock." Some specific issues to examine include work done before clocking in or after clocking out, travel time, break time, and mobile work or work from home. You are not expected to read employees' minds, but if your supervisors know that off the clock work is being performed, your organization will be liable, so drill down beyond the surface on this one to make sure you know what is really going on at ground level.

Minimum wage analysis.

Your non-exempt workers must be paid at least minimum wage for all hours worked. At this step, you will need to do the math, by dividing the employee's total weekly pay by the total number of hours worked, and make sure you are hitting the mark. Check to see if you are taking any deductions which take employees below minimum wage. Some such deductions are permitted, but many are not, so you need to make sure you understand which is which.

Overtime analysis.

You must make sure all overtime is being captured and properly paid. Under the FLSA, overtime must be paid at one and one half times the employee's regular hourly rate. This is true for all nonexempt employees, regardless of how they are paid (hourly, salaried, commissioned, piece rate, or any combination thereof). Make sure the overtime rate is being calculated accurately. Failure to include bonuses, commissions, and other incentive payments to nonexempt employees when calculating the overtime rate is a very common—and often very costly—mistake. And finally, make sure there are no illegal "comp time" arrangements going on in your organization. Private employers may not provide employees with compensatory time off ("comp time") rather than overtime. Public employers may do so, but certain very strict requirements must be met.

Check state and local laws.

While federal law is always in play when it comes to wage and hour issues, you must also check to make sure you are abiding by the requirements of applicable state and local law. Many states have minimum wage and overtime rules

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which are even more burdensome than federal law. Even if you live in a state that does not have its own minimum wage or overtime laws, most likely there is some quirky state wage law that applies, such as regulating the timing of paychecks or issuance of paychecks on termination. Some cities even have their own wage and hour codes, so be sure to check for any local rules as well.

Written policy review.

An essential step of any wage and hour self-audit includes a review of your written wage and hour policies. Ask yourself how your policies would look to a court or to the DOL. Do the policies clearly communicate your rules to supervisors and employees? Do you explain how time is recorded, how break times work, and where employees can go with any questions about these issues? Do you make clear that the company intends to comply with the law and that "off the clock" work will not be tolerated? In other words, could you effectively use your policies to defend against wage and hour claims? Most employment handbooks I have seen could use a serious overhaul in this area. A rule of thumb is if your dress code policy is longer and more detailed than your wage and hour policy, you may have a problem.

Supervisory training.

Your organization will be directly liable for your supervisors' wage and hour mistakes, such as allowing employees to work off the clock. And in addition, individual managers and owners may be individually liable for FLSA violations. Therefore, you must make sure your managers and supervisors understand at least the basics of wage and hour law, including how to handle complaints or questions about hours or pay, and that working off the clock is never allowed. Planning for supervisory training is a good way to wrap up a wage and hour audit.

About the Author

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