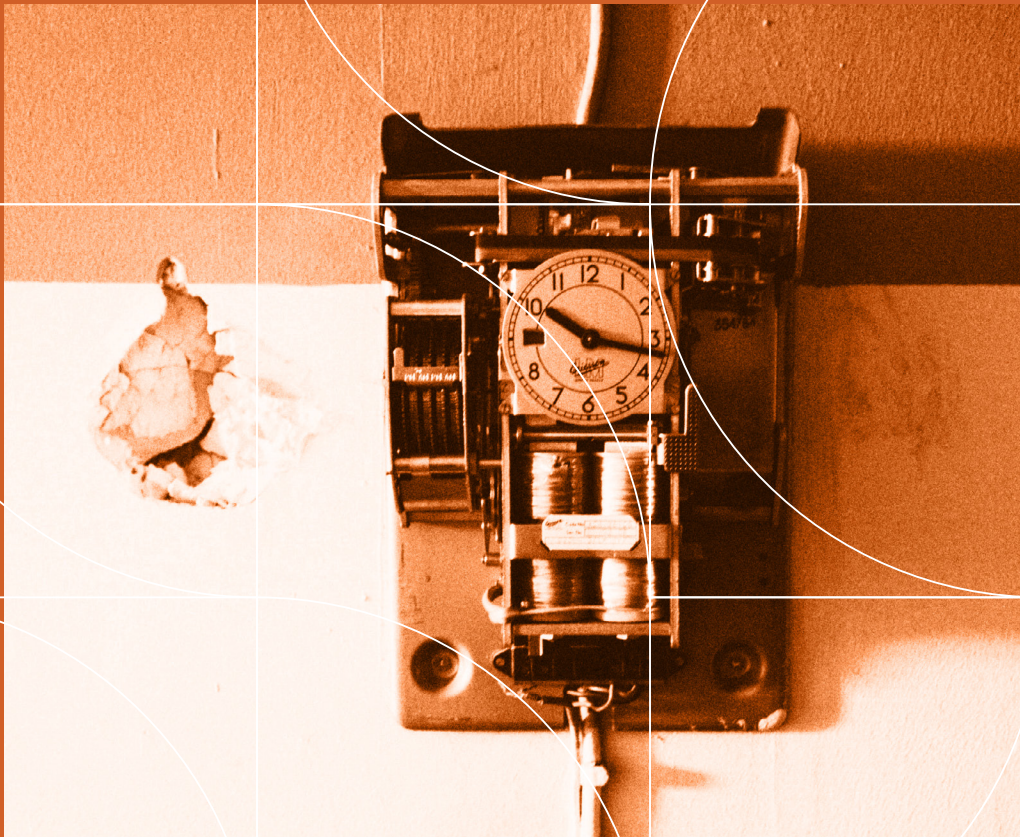




# Compliance and Prevention Matters



Excerpt from 2021 FLSA Handbook

In this chapter of our FLSA Handbook, we provide an overview of measures that an employer can take to comply with state and federal wage and hour laws. We also provide an outline to assist employers in structuring their own self-assessment process and for remediating issues determined as a result of that process.

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## **XIV. COMPLIANCE AND PREVENTION MATTERS**

### **A. Introduction and Overview**

With an antiquated statute and a mix of old and new regulations, sometimes contradictory judicial precedent, a steady stream of Supreme Court decisions on wage-hour issues, an abundance of plaintiffs' counsel attracted to wage-hour laws' fee-shifting provisions, and an active regulatory and enforcement climate, employers should not passively wait for the next lawsuit or agency investigation to hit. It will, and employers should be prepared by taking steps now to eliminate or mitigate potential risk areas.

Even if risk cannot be eliminated entirely, by engaging in a thorough self-audit of wage-hour compliance, employers stand a better chance of warding off any argument that a violation was willful — a defense that can prevent expanding the FLSA liability period from two to three years. In addition, the audit process may position the employer to assert a total defense to a claimed FLSA violation. As part of the self-audit process, an employer may ask for an Opinion Letter from the WHD, which may position it later to argue that its actions were in good faith conformity with and reliance on the letter it received, which can serve as a total defense to liability.

Because of the financially significant and legally adverse results that a self-audit can yield, employers should give thoughtful consideration to conducting the audit under the protection of the attorney-client privilege. If claims are pending or threatened, the work product doctrine may also apply. With guidance of counsel, a self-audit can be conducted and concluded in a way that permits taking any necessary remedial measures with the least possible workforce disturbance, and in a way that provides the greatest protections possible against the production of potentially damaging self-analysis materials in litigation. Absent the attorney-client umbrella, an employer's self-audit can sometimes "create bad evidence" that cannot be protected from production during litigation discovery.

### **B. Sample Internal Assessment Protocol**

A sample Wage-Hour Self-Audit Protocol is attached as Appendix 6. While this appendix sets forth one example of an approach to conducting a wage-hour audit, as always, the audit must be planned in accordance with and guided by each employer's unique workforce, products or services, organizational structure, culture and environment, and business and legal objectives. Every employer must proceed with its own audit as circumstances dictate. A thorough inquiry and advice of counsel are the best assurances that the employer's wage and hour objectives are accomplished. Employers and their counsel should structure any self-audit to cover particular compliance issues arising under wage-hour laws of the states(s) in which the employer operates as well as the FLSA.

A wage-hour self-audit follows a logical process, the key steps of which are summarized below.

#### **1. Understand the Company or Business Unit**

A preliminary step in the audit process is review of information about the business or business unit (such as a location, division, or branch) that will be the subject of the audit. For smaller employers, human resources and legal personnel likely to be involved in the audit may be closely familiar with all aspects of the company's operations. For larger companies, however, the auditors may need to enlist background research assistance from relevant managers.

As preliminary background information, the auditors will gather and review:

- Information about the operations of the audited business unit — its history and the product or service it provides.
- Information about the industry in which the business unit operates, including any “industry practices” of this industry or employer type.
- Information about types of workers employed at that business unit.
- Organizational charts.
- Information about pay practices and policies of the business unit.
- Employee handbooks and other policies.

## 2. Identify Self-Audit Purposes and Issues

The basic purpose of the self-audit is to ensure compliance with the law to help protect the company (and its managers) against financial liability and potential criminal penalties. While the audit may reveal areas of noncompliance that may result in additional labor costs, it is likely that potential areas of cost-saving also may be discovered through the audit process.

The largest part of any wage-hour audit typically is the determination of which employees can be classified as exempt from overtime requirements under federal and state law by virtue of appropriate application of one of the established exemptions. See Part VII above. This aspect of the audit and thoughtful consideration of classification decisions are especially important following the upward revision of the salary level requirement for the white-collar overtime exemptions, discussed above, which could result in some exemption reclassification decisions.

Other issues likely to be covered by a self-audit include:

- Compliance with all federal (and applicable state) employee compensation-related record-keeping requirements.
- Compliance with minimum wage payment and calculation rules.
- Proper allocation and calculation of overtime or other premium payments owed.
- Compliance with laws, regulations, and record-keeping surrounding the employment of minors.

## 3. Understand the Law

With the assistance of wage-hour counsel, before an audit is undertaken, an employer should be familiar with and understand the essential requirements imposed by the FLSA (and applicable state law(s)). It is crucial that employers understand not only what the laws require, but what they permit in terms of calculating payment of the applicable minimum wage and overtime. Before an audit is undertaken, the employer also should be aware of record-keeping,

posting, notice, and other procedural or administrative requirements. Familiarity with legal requirements, including relevant DOL Opinion Letters (discussed above) will facilitate the development of protocols and checklists.

#### 4. Gather Data

The audit typically begins by gathering documents and other raw data on the pay and duties of employees. Often, employees with similar job duties may be grouped together for consideration, as may ordinary clerical workers with no supervisory responsibilities, maintenance personnel, guards, and similar groups of nonsupervisory employees.

- **Pay data:** Initially, the auditors should gather a copy of the current payroll and corresponding time records for all employees, salaried and hourly, including all information about bonuses, commissions, or other supplemental payments.

Where compliance with meal period and rest breaks is at issue, employee schedules also should be gathered and reviewed.

An on-site review of time-punch sites (time clocks, computer terminals, etc.) should be conducted.

- **Duties data:** Job duties analysis should start with a review of relevant documents, such as job descriptions, evaluation forms, existing job analyses<sup>301</sup> (if any), and any other writings or memoranda memorializing the company's current assessment of the duties of relevant positions. If employees have been asked to complete self-evaluations, that information also will be reviewed, bearing in mind employees' frequent tendency to overstate the amount of managerial or supervisory duties that they perform.

Documents are not sufficient, however, to analyze the duties that employees actually perform. This information is most reliably gathered through interviews of position incumbents and their supervisors. Depending on the business and litigation context, employers may or may not decide to conduct interviews of position incumbents, and instead may conduct interviews only of relevant supervisors and managers. When questions about meal and break period compliance arise, however, it may be necessary to interview employees about whether, when, and how much their breaks are interrupted.

Duties analysis will also include information-gathering about any preliminary or postliminary tasks that workers perform, such as putting on protective gear or starting equipment, and review of whether such time is captured in existing time-recording systems.

This information should be obtained over a reasonable period of time, at least several months. It should contain sufficient detail to give a candid picture of the relevant employees' duties. Information gathered about job duties should be based on personal knowledge.

- **Record-keeping sampling:** The audit also should include review of a substantial sample of wage-hour records to ensure compliance with record-

keeping requirements as to both information to be maintained and period of retention.

#### 5. Tailor the Audit

The initial review of relevant pay and duties-related documents will inform the questions that are asked and the additional information that is gathered on-site. For instance, during their review of documents, auditors may observe the following:

- A large number of salaried staff, which may alert the auditors to the possibility of over-classification as exempt.
- Titles of exempt employees that are not meaningfully different from non-exempt positions, possibly suggesting that exempt and non-exempt employees perform substantially the same duties.
- Instances where paid time is inconsistent with recorded time.
- Meal break punches that may prove problematic, such as when they are for identical 30-minute periods taken at the same time every day, or when large numbers of supervisor entries/over-rides are evident.
- Unexplained extra payments in pay records.
- Deductions from salaried employees' pay that should be investigated.

#### 6. Analyze Pay Data

For *non-exempt* employees, depending upon the identified issues, analysis of pay data should focus on the following issues, which should be explored through supplemental interviews of persons with knowledge:

- The payment method (hourly, salaried/fixed week, salaried/fluctuating work week) of non-exempt employees, and any required communications with them regarding that method of pay.
- Whether time records reconcile with pay records.
- How the regular rate of pay and overtime/overtime premiums are calculated.
- Proper structuring and distribution of tips and tip-pooling arrangements.
- When and why supervisors enter shift start/end time punches or meal period start/end times.
- Benefits and leave policies and administration.

For *exempt* employees, again depending on issues identified, analysis of pay data may focus on the following issues. For each of these issues, the auditors must identify persons with knowledge and explore questions and concerns.

- Overall salary level, and weekly salary payments.
- Deductions from salary.
- Payment of and accounting for commissions as required under applicable law.
- Salary level of managers potentially classifiable as highly compensated exempt employees.
- Hourly rates paid to computer professionals.

#### 7. Analyze Duties Data for Exempt Employees

Analyzing the data collected is the process by which an employer can determine the proper classification status of workers based on known facts in light of applicable wage and hour laws and regulations. From raw data and oral briefings about duties and compensation, the auditors should be able to reach conclusions about the exempt status of some members of the relevant work force. In many cases, there will be no need to compile extensive information about members of top management and other categories of workers (such as in-house counsel or certain computer professionals).

On the other hand, there inevitably will be some and often many employees whose classification must be determined on a case-by-case basis. Employees holding lower- and mid-level management or supervisory positions are likely to require the most individualized scrutiny. For example, an employer may be called upon to analyze whether an assistant data processing manager is exempt from the FLSA's overtime provisions as an "executive" or "professional" as these terms are defined for wage-hour purposes.

As a preliminary matter, auditors must understand exactly which exempt classification (or classifications) are presumed to apply to each potentially misclassified employee — executive, administrative, or professional. Specific issues and supplemental information that may be analyzed in assessing whether those employees are properly classified as non-exempt include:

- Non-exempt employee schedules and pay information revealing whether exempt managers supervised two full-time equivalent employees.
- Manuals used by administrative exempt employees in the performance of their duties, and how they affect their independence and decision-making authority.
- Records of projects completed by administrative employees.
- Records reflecting employment decisions made or recommended by executive employees.
- Educational and certification records of professional employees.

## 8. Review Other Areas of Concern

While exempt classifications often consume the largest part of a wage-hour self-audit, other important compliance issues should be reviewed and analyzed as well, including:

- ***Employment of minors:*** Gather relevant demographic, pay, schedule, hours worked, and position information and analyze whether any minors are engaged in hazardous or other prohibited work, and whether the minor employees' work assignments otherwise comply with laws and regulations governing the employment of minors. See Part IX above.
- ***Use and classification of independent contractors:*** Analyze whether and the extent to which the employer is using workers who are classified as independent contractors and therefore deemed to be exempt from FLSA coverage. Employers should take careful stock of and scrutinize whether individuals performing work for them are properly classified as independent contractors rather than employees. See Appendix 2. Misclassification can result in a broad array of potential liabilities beyond unpaid wages and overtime, including potentially employee benefits, tax withholding, and other important legal obligations.

### C. **Sample Internal Assessment Checklists**

An employer's wage-hour audit will be more likely to address all areas of compliance concern, and to record (under the attorney-client privilege) data obtained, analyses conducted, and results reached, if it is undertaken through use of thoughtfully developed forms, checklists, and, potentially, data storage and compilation capacities. While such documents and systems should be tailored to the employer's unique factual situation and developed with assistance of counsel, some sample forms that may help to jump-start and guide the process are described below and attached as appendices to this *Handbook*.

#### 1. Pay Practices

Appendix 7 contains examples of how to properly calculate overtime under federal law for non-exempt employees paid on a fluctuating workweek agreement.

#### 2. Exempt Classifications

Sample checklists to examine the applicability of "white-collar" (executive, administrative, and professional) exemptions are provided in Appendices 8 and 9.

#### 3. Independent Contractors

Appendix 2 provides a sample to examine whether workers are properly classified as "independent contractors," as opposed to employees, for wage-hour compliance purposes. See Part X above.

#### 4. Joint Employment

A sample checklist for reviewing potential exposure based on a finding of joint employer status is contained in Appendix 10. Related issues are discussed in Part X above.



#### **D. Remediation Plans and Factors to Consider**

What should an employer do if a self-audit reveals that certain employees have been improperly classified as exempt from overtime due, perhaps, to a change in their duties? Should an employer simply reclassify the employee as non-exempt going forward? Should the employer offer back pay for overtime owed? If so, for what period? Did the employer maintain records for the misclassified employee on which an overtime calculation could be based? Should the employer seek a release of claims and, if so, how should that be implemented? These questions often arise after a self-audit and require thoughtful consideration with guidance from experienced wage-hour counsel.

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