

Eight Steps for Examining Your Wage Practices

By Jennifer Brown Shaw, Esq.; Shaw Law Group, PC

Wage-and-hour compensation issues remain some of the most active enforcement areas in employment law. These issues represent substantial lost wages for employees and lost tax revenues for government.

Self audits can serve as a key tool to help employers avoid wage-and-hour liability in the workplace, especially given the current climate of increased enforcement and scrutiny.

For example, under California's Fair Pay Act, employers must be particularly proactive to ensure pay equality between men and women performing similar work.

Employers must ensure their records and practices are compliant, or they face significant legal risk ...

Employers should keep these key steps in mind when planning for and starting a self audit:

- Consider whether to use counsel;
- Define the scope;
- Identify applicable laws and regulations;
- Develop specific audit tools;
- Get everyone on board;
- Execute the audit;
- Summarize the results; and
- Implement the necessary changes to correct any errors uncovered during the audit.

Enforcement Activity

Enforcement agencies in California have stepped up efforts to target employers who perpetrate “wage theft.” “Wage theft” is a phrase used to refer to infractions of the California Labor Code involving the payment of wages to workers.

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Wage theft might refer to employers who fail to pay for all hours worked, fail to pay nonexempt employees overtime, fail to pay minimum wage or fail to properly classify workers as employees and report them to various state and federal agencies.

Failure to comply with state wage-and-hour practices may result in heavy fines, civil or criminal penalties, and class-action lawsuits. In 2016, the Labor Commissioner issued a five-year [report](#) showing increased enforcement. The total number of businesses inspected increased from 999 in 2012 to 4,506 in 2016. The total assessment amount increased nearly five-fold, from \$7,232,785 in 2013 to \$35,339,002 in 2016.

The Labor Commissioner's simplified practices for bringing many wage and hour claims (including claims for unreimbursed business expenses and enforcement of local minimum wage and overtime ordinances), make it easy for employees to bring these claims without first notifying their employers of any problems or inadvertent violations.

Then, beginning in 2021, California law allowed local jurisdictions (cities, counties, districts, agencies or subdivisions, or combinations thereof) to enforce state wage requirements.

Most recently, starting January 1, 2022, a new law makes the intentional theft of wages (i.e., the employer knows the wages are due under the law) in the amount greater than \$950 for one employee or more than \$2,350 for two or more employees punishable as *grand theft* under the California Penal Code, which prosecutors may charge as a misdemeanor or felony.

A word of caution: These audits can backfire if not properly conducted ...

In light of this increased enforcement and the continuing prevalence of class-action lawsuits in California, employers should take steps to evaluate their practices and ensure compliance with the law and consider whether a self audit is right for them.

Why Self Audit?

The purpose of a self audit is to identify policies, procedures and practices that violate the law. Given the complexity of the laws involved, audits invariably reveal some compliance issues.

By taking a proactive approach, employers retain control over correcting the issues identified by an audit and are better prepared to defend themselves if the government or a plaintiff's attorney comes calling.

An employer-initiated self audit can also be used in connection with pending Labor Commissioner claims to voluntarily correct violations and reduce any fines or penalties that might be assessed.

What Is a Self Audit?

A self audit is simply an internal review of an employer's practices.

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In the wage-hour arena, a self audit focuses on the employer's compensation practices. At a minimum, the audit generally should include the following areas:

- Employee classification (exempt versus nonexempt);
- Meal and rest periods;
- Timekeeping and pay practices;
- Calculation of the “regular rate of pay” and related overtime issues;
- Off-the-clock work;
- Pay equality between men and women, and persons of different races and ethnicities performing similar work;
- Child labor practices;
- Record keeping and wage statement compliance; and
- Classification of workers as independent contractors.

How to Conduct a Self Audit

Consider these key factors when preparing for a self audit.

1. Consider Retaining Counsel

Before the audit, determine whether you will use legal counsel as part of the process.

Keep at least two important things in mind when making this decision:

- First, wage-hour law is complex. Although the statutory and regulatory framework is relatively stable, case law is not. It varies by jurisdiction and constantly changes. It's so complicated that some employment lawyers and human resources professionals focus exclusively on wage-hour compliance.
- Second, consider the potentially significant attorney-client privilege issues at stake. If counsel is *not* involved, there is no attorney-client or attorney-work-product privilege available down the road to protect the results of the audit from disclosure. If counsel *is* involved, any legal or risk analysis, recommendations, conclusions and communications with counsel will remain confidential. This is particularly important if the audit reveals significant compliance problems.

Self audits should be well organized and strategic ...

Of course, attorneys are expensive and not always necessary. Employers should evaluate the benefits of attorney involvement in light of the costs involved. For example, if you know of compliance problems in your business and you believe that it's likely that you will face future lawsuits related to those problem areas, an investment in hiring counsel will almost certainly pay off.

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On the other hand, if you regularly conduct audits and do not find problem areas, then counsel may be an unnecessary expense. If you decide to retain counsel, ensure that he/she is experienced in wage-hour law and understands the audit process.

2. Define the Scope

To determine the scope of the audit, you'll need to consider several issues:

- What is the timeline of the audit?
- What areas will the audit focus on? For example, are you concerned about your compliance with overtime pay requirements? Exempt versus nonexempt classification? Or whether meal and rest breaks are being provided in a timely manner?
- Will you evaluate the entire organization?
- Will you evaluate only certain departments or job classifications?

An analysis of the risk areas in the organization should drive these decisions. For instance, do you know whether many employees skip their rest breaks and meal periods? If so, that should be a key focus area for the audit.

When laws conflict, there is often no easy answer to the question of which law prevails ...

3. Identify the Rules

Identify the laws that apply. This will vary based on the employees subject to audit, where your operations are located and what industry you are in.

Most California employers will need to review:

- California's Labor Code;
- The applicable California [Wage Order](#);
- Opinion letters and the *Enforcement Policies and Interpretations Manual* from the [Division of Labor Standards Enforcement](#);
- The federal [Fair Labor Standards Act \(FLSA\)](#); and
- Regulations from the [U.S. Department of Labor](#).

Although California law generally is stricter than federal law, as a California employer, you are subject to employment laws and regulations from the state and federal governments and from other jurisdictions that legislate on employment matters.

In general, you must follow the law most restrictive to the employer and most generous to the employee.

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4. Develop Your Audit Tools

Written policies and other materials are important audit documents. However, the goal of any audit should be to analyze actual operations.

Audit tools such as surveys and questionnaires, employee interviews and targeted document reviews (payroll records, applicable policies, job descriptions, card punch reports, etc.) can play an important role in the data-gathering phase of the audit.

When developing audit tools, it is important to strategize about the ultimate goals of the audit. For example, if you suspect misclassification of employees as exempt and simply want to identify the magnitude of the problem, you may want to interview managers instead of individual employees about the duties of the positions at issue.

It can be risky to conduct an audit before there is consensus about what to do if problem areas are identified ...

5. Get Everyone on Board

Many of us resist self-analysis, especially when we fear it may reveal flaws or problem areas. The same is true for organizations. Fixing problems identified during an audit can be expensive and require operational changes. It's important to ensure the right people are committed to the audit from the outset.

6. Execute the Audit

At this point, you are ready to start the audit. Be methodical and thorough. Follow the plan you developed initially, but be prepared for detours. Also, be sure those individuals involved in organizing the audit understand the need for confidentiality and do not inappropriately reveal information gathered during the audit process.

7. Summarize the Results

When the audit is complete, summarize the findings. If you are working with counsel, he/she should prepare the findings. Otherwise, the HR manager, risk manager or other strategic partner can do so.

To minimize potential liability, it's important to ensure the audit results are made available only to those limited individuals in the organization with a "need to know," particularly if counsel is involved. Otherwise, the attorney-client/attorney-work-product privileges may be lost.

8. Act on the Results

The final step in an audit is deciding what needs to be fixed, if anything. Of course, self-corrective measures can be operationally, financially and emotionally difficult. But failing to correct known violations will leave an organization open to greater liability.

If an audit reveals clear liability, you must determine whether to address issues going forward only, or attempt to remedy past mistakes (by providing back pay or paying the missed meal period premium, as two examples). This decision depends primarily on corporate values, risk tolerance and underlying costs, among other things.

Big Decision

Committing your organization to a wage-hour self audit is a big decision. Performing the audit and implementing self-corrective measures based on the results can be painstaking and expensive.


In the long run, though, such efforts can deliver big returns.

About the Author: Jennifer Brown Shaw, Esq., is a founding partner of Shaw Law Group, PC, a Sacramento/ San Francisco employment law boutique. The firm's practice focuses exclusively on representing management in employment law advice, training, investigations, litigation and appeals.

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