HOW TO CONDUCT AN EFFECTIVE WAGE CLASSIFICATION AUDIT – IS THE POSITION EXEMPT OR NON-EXEMPT?

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DOL NOTICE OF PROPOSED RULE MAKING

- On March 7, 2019, the Department of Labor announced a proposed rule that would make over 1 million more American workers eligible for overtime pay.

- Under the currently enforced law, employees with a salary above $455/week ($23,660 annually) are not entitled to overtime pay.

- UPDATE: the Department’s recent proposal, however, would raise the salary level to $679/week ($35,308 annually) making employees between the $23k-$35k threshold non-exempt and eligible for overtime pay.
NOTICE OF PROPOSED RULE MAKING

- The proposal would also increase the total annual compensation required for “highly compensated employees” from the currently-enforced level of $100,000 to $147,414 per year

- Employers would be allowed to use non-discretionary bonuses and incentive payments (including commissions) to satisfy up to 10% of the new salary level
  - Bonuses/commissions must be paid annually or on a more frequent basis
NOTICE OF PROPOSED RULE MAKING

- No changes to the job duties test for executive, administrative, and professional employees
- No automatic adjustments to the salary threshold in the future
- The Department is still considering timely comments in developing a final rule
- **NOTE**: Changes will likely go into effect early 2020 when the final rule is established
WITH THESE CHANGES ON THE HORIZON – NOW IS A GOOD TIME TO CONDUCT A WAGE CLASSIFICATION AUDIT
WHY IS AN AUDIT IMPORTANT?

- 2018 was a record year for wage and hour claims filed by the Department of Labor
  - Recovered a record $304 million in wages
- Need to evaluate and manage risk of classifications. High risk areas:
  - Exempt v. non-exempt
  - Employee v. independent contractor
- Make sure pay differences are based on legitimate business justifications
- Collective actions get expensive quickly
OUTLINE FOR AN AUDIT

- Pre-audit work
- Select scope and positions
- Select interviewer
- Prepare questionnaire
- Select interview process and conduct interviews
- Document results and prepare report
- Implement changes
PRE-AUDIT WORK

- Check payroll policies to make sure they are updated and compliant
- Policy prohibits “working off the clock”
- Employee has a duty to report all hours worked
- Company has mechanism/form for non-exempt employees to report hours worked away from jobsite
- Train managers and supervisors to enforce policies
SELECT SCOPE AND POSITIONS

Three buckets of positions

- **Bucket 1**: Non-exempt employees
  - Make sure employees have knowledge of policies
  - Identify pay discrepancies and determine if additional information is needed on business justifications for pay discrepancies
  - Confirm non-discretionary bonuses rolled into regular rate for overtime

- **Bucket 2**: Exempt employees on the edge or positions classified differently
  - Employees making a salary less than $40,000
  - Positions that human resources or managers have questions about
  - Also, could include questionable independent contractors in this group
SELECT SCOPE AND POSITIONS

Three buckets of positions (cont.)

- **Bucket 3:** Exempt employees that are in clearly categorized exempt positions
  - Confirm no improper deductions
  - Confirm safe harbor provision in payroll policies
  - Don’t lose exemption on disallowed deductions
SELECT SCOPE AND POSITIONS

- From your 2\textsuperscript{nd} bucket
  - Identify specific job positions to review
  - Collect job descriptions
  - Collect payroll information
  - Identify independent contractors to review
SELECT INTERVIEWER

Who conducts the interview?

- Human Resources
  - Knowledge of company
  - Cost effective
  - Limits protection of “good faith”

- Outside Counsel
  - Potentially better knowledge of exemptions
  - “Good faith” defense in litigation and privileges
  - Cost prohibitive

- Good Faith defense:
  - A defense to liquidated damages: (1) company actually believed its pay practices complied with the law; and (2) its actual belief was reasonable. Evaluate advise and recommendations of counsel in establishing defense.
PREPARE QUESTIONNAIRE (ASSUMING ACTUAL INTERVIEWS)

- Comprehensive questionnaire helps in interviews and lays out plan of questions

- Create outline of questions and issues for each exemption (All-white collar exemptions)
  - State specific as needed

- Provide space or form for interview notes

- Process may be time consuming but important to structure interviews and cover legal issues of each potential exemption

- Cover salary level and salary basis questions
  - Confirm no improper deductions
SELECT INTERVIEW PROCESS AND CONDUCT

Three types of interview process

1. **Paper Review** – Review job descriptions and payroll records only
   - Least effective approach
   - DOL says job descriptions do not matter – exemption based on actual job duties performed

2. **Interview Managers/Supervisors**
   - Better than paper review, but still not the best
SELECT INTERVIEW PROCESS AND CONDUCT

Three types of interview process (cont.)

3. **Interview Employees Performing the Job Duties**
   - Best approach and collects actual information of job duties performed
   - May generate questions and concerns from employees
   - If large company, select sample size to collect a comprehensive evaluation
     - Maybe 15% to 20% sample size for positions
     - Make sure regions are covered in sample size
CONDUCT INTERVIEWS/DOCUMENT PROCESS

- Use same groups/people to conduct interviews for consistency
- Review job description before interviews
- For interviews, prepare and maintain notes for each interview
- Collect detailed information in notes
  - No summary responses
  - Obtain examples
- Prepare a summary finding following interview
  - One page report from interview completed close to completion of the interview
  - Makes a recommendation
DOCUMENT PROCESS/PREPARE THE REPORT

- Maintain all notes and summary findings
- Collect notes and maintain
- Collect summary findings and make a determination on classification of position
- From summary findings prepare report of findings
- Select categories for final report
  - Red, yellow and green
  - Based on risk tolerance Company can make decision on how to classify going forward
BASED ON FINAL REPORT MAKE A DECISION

- **Green** – Leave position as exempt
- **Yellow** – May leave as exempt, but understand the risk and will tolerate it
- **If close call** – Add job duties in job description and in performance of position to strengthen exemption qualification
BASED ON FINAL REPORT MAKE A DECISION

- Red – Convert position to non-exempt
- Calculate change based on current salary to minimize financial impact to company
  - Pay back wages?
- Be cautious of the same position classified differently
  - Have an explanation (regional or market approach)
FOLLOWING AN AUDIT

- Evaluate questionable positions on a regular or annual basis

- In audits, and on similar timely basis, monitor pay discrepancies in same positions and confirm legitimate business reasons for pay differences inside the same position (seniority, merit, quality/quantity of production, or reason not based on sex)
QUESTIONS?

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THANK YOU

Legal Disclaimer: This document is not intended to give legal advice. It is comprised of general information. Employers facing specific issues should seek the assistance of an attorney.