**Conducting a Wage and Hour Audit: A Practical Guide to FLSA Compliance**

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**Abstract**

Compensation of workers in most larger firms can be very complex due to the nature of pay policies and procedures and the method of calculation. Many regulations are in place to ensure employees are paid fairly and in alignment with the minimum wage requirement while protecting youth in the workplace. Today, the hours worked, and the jobs performed in firms operating within the U.S. are heavily regulated to ensure fairness as well as the health and safety of all workers. This article provides an overview of the FLSA requirements for managers and human resource professionals. It also gives examples of current court cases to provide insight into the current legal environment in which this law operates. Lastly, the authors provide a compensation audit framework for HR professionals to ensure that their organization complies with the various provisions of the FLSA.

*Keywords:* Fair Labor Standards Act, FLSA, pay audits, wage and hour procedures

**Introduction**

For managers, employees, and human resource professionals in the U.S., the Fair Labor Standards Act (FLSA) of 1938 is the primary federal law governing pay policies and procedures. It is enforced by the Wage and Hour Division of the Department of Labor (DOL). The FLSA was passed to ensure that all employees are paid fairly and in accordance with federal legal standards (Chaney, 2022). The FLSA focuses on compliance in four areas, which include (1) minimum wage mandates, (2) limitations imposed on the use of child labor, (3) exempt and nonexempt status for overtime pay, and (4) record-keeping requirements (Jackson, Mathis, Meglich, and Valentine, 2017).

While the FLSA is the governing law at the federal level, it should be noted that state and local laws may provide additional coverage and requirements that federal law does not. When any of these laws are violated, firms may be required to pay a hefty price, as witnessed by the recent Uber and Lyft case settlement in which the two companies agreed to pay a combined amount of $328 million for withholding part of the wages from their drivers.

This paper focuses primarily on the relevant provisions of federal legislation and their interpretations in the legal environment. However, examples of state laws that differ from federal requirements will be provided. For example, Florida has its own legal requirements for labeling someone as an employee or independent contractor (Florida Law, 2022). The authors will also focus on the importance of human resource professionals understanding and conducting audits of their firm’s procedures and policies to comply with the FLSA.

**Fair Labor Standards Act Requirements**

The following sections provide a brief overview of the federal law provisions and an exploration of recent cases involving the violation of these requirements. This will help to provide a framework regarding the types of violations prominent in the courts today.

**The Minimum Wage Provision**

The FLSA states a federal minimum wage of $7.25 per hour (effective on July 24, 2009) for employees in the United States. Also, each state can have its own minimum wage requirements. It should be clarified that states can set a rate higher than the federal minimum wage, but not below the federal minimum. For example, while some states such as Texas, Indiana, Pennsylvania, and North Carolina match this federal standard, other states, such as Washington ($15.74), California ($15.50), and Massachusetts/Connecticut ($15.00), far exceed it. Finally, some states, such as South Carolina, Louisiana, and Tennessee, choose not to pass minimum wage laws at the state level.

For employees who work for tips, the combined wages from cash and tips are expected to equal the federal minimum wage. Managers and human resources professionals must make sure that the total compensation of employees who receive tips equals or exceeds the federal minimum wage standards for any given week.

Some employees might receive a flat rate per week or per month. However, it is the responsibility of the organization to make sure all payments are in alignment with the minimum hourly wage rates as per FLSA (Noe, Hollenbeck, Gerhart, & Wright, 2023). To calculate employee wages for the purpose of meeting the minimum wage requirement of the FLSA, the owners, managers, or HR professionals can divide the employee’s overall earnings for the week by the number of compensable hours the employee worked during those seven days. The hourly rate paid to the employees should be at least the minimum wage for any given week for employers to satisfy FLSA’s minimum wage requirement. The FLSA specifies that a given workweek is any seven consecutive 24-hour periods or 168 consecutive hours, which can begin on any day of the week (eLaws Advisor, 2022).

The FLSA does not require companies to provide a specific number of days as vacation time, holidays, or sick leave (eLaws Advisor, 2022). Furthermore, the FLSA does not mandate any meal or rest breaks, fringe benefits, severance pay, etc., as these are usually offered by employers to remain competitive in the industry by attracting, hiring, and retaining the best talent. Although the FLSA does not require employers to offer meal or rest breaks, if such benefits are provided, breaks may be compensable if employees perform work during that time. Certain benefits like vacation time, free meals, and sick time can be required by state or local laws, or as part of a collective bargaining agreement (CBA) with union representatives or a specific agreement between the employer and employees during the negotiation agreement at the initial hiring process.

Managers and employees should be aware that “wait times” are another issue that should be considered in each employee’s remuneration package. For example, if employees are engaged to wait to perform their tasks or responsibilities until work arrives at their station in the value chain, the wait time is generally compensable. However, if the employee or contractor is waiting to be engaged, such as Uber and Lyft drivers who are waiting for a customer to book a ride, the time may not be compensable. Some employees might be on call to perform their duties. Generally, the more constraints on an employee’s activities while they are waiting or are on standby, the more likely that their time is compensable and should receive pay.

Some employees also receive compensation for travel time. The compensability of travel time usually depends on the type of travel and how far it is from the headquarters and home location of the employee. For example, when a worker travels from home to work every day, generally, this is not considered to be working time. However, when an employee must travel from the company office area to the actual job site where the work is being performed during work hours, then this travel time should be compensable.

***Cases Regarding the Minimum Wage***

The *Ochoa v. McDonald's Corp* (Madani, 2019) case involved McDonald's franchises in California that were accused of violating the FLSA's minimum wage and overtime provisions. The plaintiffs alleged that McDonald's was a joint employer and, therefore, responsible for the franchisees' violations. In a settlement agreement, McDonald's agreed to pay $26 million to the plaintiffs. The case shows that in a joint employer case, a corporation cannot delegate the responsibility and accountability of making sure employees are paid in accordance with federal laws to their franchisors. In joint employer cases, both parties are accountable. As observed from the “deep pocket” theory, most lawsuits will target the larger and more profitable joint employer entity, such as the McDonald’s Corporation, rather than the franchise.

*Hernandez v. Border Foods, Inc.* (U.S. Department of Labor, 2021) involved Border Foods, a franchisee of Taco Bell restaurants. Allegedly, the company failed to compensate employees for all the hours worked, including hours worked before and after scheduled shifts, and did not provide employees with required overtime pay for all hours worked over 40 hours in a workweek. As a result, the company agreed to pay over $5 million in back wages and damages to its employees.

*Guzman v. Sierra Gold Sales Corp* (Department of Labor, 2021) began with a complaint filed by a group of janitorial workers who alleged that they were not paid for all hours worked and were not paid the minimum wage nor the overtime required by law. The U.S. Department of Labor alleged that Sierra Gold Sales Corp. had failed to record all the hours worked by its employees, resulting in the workers being underpaid. The company also failed to maintain accurate records of employees' wages and hours worked in violation of the FLSA's recordkeeping requirements. The company agreed to pay a total of $250,341 in back wages and damages to the workers and committed to future compliance with FLSA regulations.

The influx of illegal immigrants has also had an impact on the number of violations of the minimum wage provision of the FLSA. In its continuing effort to combat labor abuses of immigrant workers in Southern California's logistics and warehousing industries, the U.S. Department of Labor recently recovered $1.1 million from two companies, Freig Carrillo Forwarding Inc. and ACV Logistics Inc., two firms that had underpaid fifty Mexican nationals, some of whom were paid as little as $2.43 an hour (News Bites, 2023).

Some HR professionals and managers fail to recognize and count actual hours worked as compensable due to improper record keeping or confusion regarding the employee being on a break or no longer “on the clock” which can easily become a violation of minimum wage law. For example, a worker that “punches out” or “clocks out” but continues to stay at his/her workstation while resting or eating, and regularly answers colleagues’ or customers’ work-related questions, answers telephone calls for the company, or helps vendors should be paid. The law requires that this time must be counted as hours worked and should be paid as compensable hours because the employee performed duties that advance the well-being of the department or company (U.S. Department of Labor, 2022).

**Child Labor Laws**

In the U.S., federal and state laws provide specific protections for minors regarding work for compensation, experience, and even internships. Even so, in 2016 there were around 160,000 young workers in the U.S. who suffered an occupational injury, and 54,800 of them ended up in the emergency room (U.S. Department of Labor, 2016). Seven years later, children are still being illegally employed to work under dangerous conditions in violation of federal laws (Semuels, 2023).

The Child Labor Provisions of the FLSA were enacted to make sure that when underage teenagers (those around 14-17 years of age) are working, they are doing so under safe working conditions. For example, these young workers are expected to continue their education without the interference of work obligations. Also, young people are not allowed to operate heavy machinery or work in hazardous situations which can jeopardize their health and overall wellbeing. Also, this does not just apply to jobs in roofing or heavy industry. For example, if shoppers walk into any local Publix, Target, or Walmart store’s bakery or deli department, they are likely to see many large machines or slicers restricted for use by those 18 years of age or older. Of course, the Occupational Health and Safety Act (OSHA) also reinforces the idea of a safe working environment.

Hiring minors between the ages of 14-17 requires careful scheduling as the FLSA confines the type of jobs and the times these youth can work. For example, a 14–15-year-old may not be employed (Child Labor Provisions, 2016):

* During school hours when they are expected to attend class and study.
* Before 7 a.m. or after 7 p.m., except holidays.
* More than 3 hours a day on a school day including on Fridays.
* More than 8 hours a day on a non-school day.
* More than 18 hours a week during a school week.
* More than 40 hours a week during non-school weeks.

Furthermore, minors cannot be employed to do any manufacturing, mining, or processing of foods, filleting, laundering, bulking, etc. As seen from data in Table 1, over the past five years, there has been a rise in the number of minors being employed in violation of these laws, and there has been a significant increase in the imposed penalties. To eliminate injuries, while some exceptions might apply, minors, in general, should not work in an engine room, repair hazardous machines or equipment, use ladders or scaffolds, or load and unload goods and property from any motor vehicles, railroads, and conveyors.

**Table 1**
*Child Labor Enforcement Statistics, U.S. Department of Labor*

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|   | **FY 2023** | **2022** | **2021** | **2020** | **2019** | **2018** | **2017** |
| *Cases With Child Labor Violations* | 955 | 835 | 747 | 851 | 858 | 853 | 748 |
| *Minors Employed in Violation* | 5,792 | 3,876 | 2,819 | 3,395 | 3,073 | 2,299 | 1,609 |
| *Minors Per Case* | 6 | 5 | 4 | 4 | 4 | 3 | 2 |
| *Cases With Hazardous Occupation Violations* | 196 | 216 | 208 | 266 | 240 | 300 | 240 |
| *Minors Employed in Violation of Hazardous Occupation* | 502 | 688 | 545 | 633 | 544 | 596 | 491 |
| *Child Labor Civil Money Penalties* | $8,039,728 | $4,386,205 | $3,394,646 | $3,579,571 | $3,183,584 | $2,690,650 | $1,963,499 |
| Source: Child Labor, link: <https://www.dol.gov/agencies/whd/data/charts/child-labor> |

While the federal youth employment provisions do not always require underage workers to obtain work permits, physical assessments, or school permission, many state laws do require such permissions before young people can work. Some American states prevent young teenagers from getting their first job due to the requirements of a work permit from school administrators and/or government officials (Fick & Holik, 2022). Some states like Michigan, Ohio, and Pennsylvania require teenagers to secure a work permit from their school administrators, pass a physical examination through their medical doctors, and/or get a permit from their district where they want to work. Consequently, Fick and Holik (2022) explain how historical data shows that in the 1970s about 60% of the 16–19-year teenagers had some type of compensable job. This figure declined significantly over the last five decades to about 36% in 2021. Consequently, we see a pattern of fewer young people getting work experience during their teenage years while they complete their high school education.

Youth having a job is not a bad thing. Researchers have emphasized that when teenagers work, their rates of substance abuse decrease, their chances of graduating from high school increase, and they learn to get along with others in society (Fick & Holik, 2022, para. 9). Additionally, Fick and Holik mention that teenagers with one year of work experience tend to have annual incomes of about 15% higher in their 20s compared to those that did not work during their high school years of education. Despite the benefits of gaining work experience as a teenager, this employment must be within legal parameters.

According to the DOL, the department’s Wage and Hour Division found violations in nearly 85% of its restaurant investigations during 2021, leading to the recovery of more than $34.7 million in back wages for over 29,000 workers. The finding resulted in $3.2 million in penalties to employers for violations of the FLSA and other federal labor laws, related to the federal minimum wage, overtime pay, tips, employment of child labor, and making illegal wage deductions (Feingold, 2023).

***Child Labor Cases***

Even though the FLSA has provided protection for working youth for more than 85 years, companies are still violating these laws. Many recent violations include allowing minors to work in dangerous situations, though some also include violations based on the number of hours worked. This is exemplified by the cases described in Table 2.

**Table 2**

*Child Labor Violation Cases*

|  |  |
| --- | --- |
| **Case** | **Details** |
| *United States v. B&B Tobacco Products Corp.* (2017). | This case involved a lawsuit against B&B Tobacco Products for allowing minors under the age of 18 to perform dangerous jobs, in violation of the FLSA's provisions on child labor. The company agreed to pay $150,000 in penalties and to implement new child labor training programs. |
| *United States v. Case Farms Processing, Inc*. (2017). | The court found that the company had allowed minors under the age of 18 to perform dangerous jobs, such as operating meat-processing machinery. Case Farms agreed to pay $275,000 in penalties and to implement new child labor training programs. |
| *United States v. PCC Structurals, Inc*. (2018). | The court found that the company had allowed minors under the age of 18 to perform dangerous jobs, such as operating heavy machinery. PCC Structurals agreed to pay $225,000 in penalties and to implement new child labor training programs. |
| *United States v. JBS USA, LLC* (2021). | The court found that the company had allowed minors under the age of 18 to perform dangerous jobs, such as operating meat-processing machinery. JBS USA agreed to pay $146,000 in penalties and to implement new child labor training programs.  |
| *Wage and Hour Division v. Yan Yan Food, Inc*., (case number 1:20-cv-02094). | This was a case in the U.S. District Court for the Eastern District of New York. Here, a New York-based snack food manufacturer was found to have violated the FLSA's child labor provisions by allowing 22 minors to work more hours than permitted under the law. As in the previously discussed cases, the company had also allowed minors to operate hazardous machinery. The company agreed to pay $236,442 in back wages and penalties to the affected employees and to implement measures to ensure future compliance with child labor laws. |
| Source: U.S. Department of Labor: https//www.dol.gov/ |

The cases cited in Table 2 are just some examples of violations involving the FLSA and child labor. It is important to understand all aspects of the law regarding minors and as well as adults to avoid any violations of applicable laws. For example, managers must also understand why some workers are classified as exempt while others are labeled as nonexempt so schedules can be made in accordance with applicable regulations.

**Worker Classification**

*Exempt vs. Nonexempt Classification*

Under the FLSA, a company’s workers can be classified as exempt or nonexempt. Exempt employees usually hold positions (often managerial in rank) that are not always paid overtime. There are several categories to determine if a job classifies for exempt status, including executive, administrative, professional, computer, and outside sales. Nonexempt employees are required to be paid overtime when they work more than 40 hours per week or on holidays, and all hours worked in excess of 40 hours per week must be paid 1.5 times the regular pay rate (Jackson et al., 2017).

While nonexempt employees may not be intentionally scheduled to work overtime, employers must consider issues such as training time, travel time for work, and after-hours duties (e.g., responding to emails from colleagues, vendors, customers, and/or government officials). The rule is that the time spent by workers for on-the-job training should count towards time worked, even if this leads to overtime pay. Furthermore, work-related travel time should be paid. Companies are required to keep their wage and hour records for at least three years (Smith, 2022).

Also, in today’s environment, some of the complex questions being addressed revolve around volunteers and contract workers. These workers can include volunteer firefighters and Uber drivers, as discussed below.

*Employee vs. Independent Contractor*

Managers must pay both employees and contractors according to established laws. The main issue regarding whether a person is considered an employee or a contractor comes down to who controls how and when the job is being done and the level of economic dependence of the worker on the employer (Fenton, 2021). If an employer can control how some of the work is being done or controls the work on a step-by-step basis, then the worker must be seen as an employee. However, if the employer is only concerned about the results of the labor and not the process, then the worker can be considered an independent contractor.

States vary widely in respect to legal tests for independent contractors. The Internal Revenue Service (IRS), as well as 18 states (including Florida, Mississippi, New York, and Iowa) and the District of Columbia, use the Independent Contractor Common Law Test to determine who can be classified as an independent contractor. The classification is based on whether an employer has one of the following types of control over an employee:

1. *Financial control*. Employers determine how much to pay and how to maximize performance in exchange for compensation.
2. *Behavioral control*. Through orientation and onboarding practices coupled with ongoing training programs, managers create the standard norms for dealing with customers, vendors, and other relevant stakeholders each day.
3. *Rank and authority control*. This level of influence depends on the type of relationship that exists between the employer and the worker (Watts, 2023).

The right to control is a critical element when determining whether a worker is an independent contractor or an employee. Using a hypothetical “volunteer” male firefighter, as an example, because he does not set his own schedule (financial control), gets trained by the city (behavioral control), has a continuing relationship with the employer, is required to attend at least 30% of all calls to remain active, must perform according to the required procedure of the city, and earns over $600 per year, he should be seen and treated as an employee. In this relationship, the employer is in control of how and when the individual works; as such, the worker should be labeled as an employee (not an independent contractor). However, the Fair Labor Standards Act states that those who are categorized as “volunteers” cannot be put in the category of employees (Fenton, 2021, para. 3).

The ABC Test is a similar, though somewhat stricter doctrine used by the U.S. Department of Labor and 33 states. Under this doctrine, a worker is considered an independent contractor if the employer-employee relationship meets the following criteria:

* **A**bsence of Control – The employer does not have direct control over the employee.
* Unusual **B**usiness – The work performed is not part of the employer’s usual course of business.
* **C**ustomary Engagement – The worker has an independently established trade occupation or business (Watts, 2023).

For payment and compensation purposes, the U.S. Supreme Court has clarified that a specific rule or test cannot be the sole determinant of whether a worker is an employee or an independent contractor (Fenton, 2021; U.S. Department of Labor, 2022). Rather, according to the Supreme Court, it is the totality of the circumstances related to the job and overall process that must be considered as a test for determining if a person is an employee or an independent contractor, including:

1. The permanency of the employer-worker relationship.
2. The alleged investment in equipment and facilities.
3. The degree of control by the employer or the managers.
4. The alleged opportunities for profit and loss.
5. The extent to which the services rendered by the employee or independent contractor are an integral part of the employer’s business.
6. The employee or independent contractor’s degree of independent business operation and organization.
7. The amount of initiative required by the worker for success.

State laws are likely to be fully aligned with the federal regulations and cases decided by the Supreme Court. Since volunteer firefighters get trained by the city, receive proper clothing and equipment, and get the necessary vehicles from the local government to fight fires, the worker can and should be entitled to an “employee status” (eLaw Advisors, 2022).

Finally, the specific location where the job is performed can be a factor, but it is not always a necessary component as other criteria might weigh more heavily in determining whether a person is an employee or an independent contractor. The fire station, although not the main location of all work, is an important central location for all firefighters for training, development, and teamwork (Mujtaba & Kaifi, 2023).

*Classification Cases*

There have been several high-profile legal cases in the United States that address the issue of whether workers should be classified as "nonexempt" and eligible for overtime pay. For example, there have been several class action lawsuits against the Target Corporation based on misclassification of employees as “exempt” employees. In the recent class action case, *Davis v. Target* (2020), Andrew Davis alleged that Target classified employees as “team leaders” who were scheduled to work 50 or more hours per week without receiving overtime pay. However, these “team leaders were expected to spend more than half of their time performing the non-managerial tasks of hourly employees, such as checking out customers and stocking shelves. This was in violation of the FSLA” (Nesterak, 2020a). “Exempt” workers are allowed to do non-management work, under the law; however, their *primary* duty must be management.

Previously, five separate class action suits were filed against Target in various states for this same issue of “team leaders” being assigned an “exempt” status. In all these previous cases, the plaintiffs settled with Target before the judge had the opportunity to certify the cases as a class action. This issue seems to be pervasive in the retail sector, with similar lawsuits being filed against Walmart, Home Depot, Family Dollar, Lowes, and Big Lot, costing these retailers millions of dollars in back pay and fines (Nasterak, 2020b).

Other cases question whether independent contractors are not entitled to overtime pay or other employment benefits. These cases illustrate the importance of accurately classifying workers for purposes of wage and hour laws and demonstrate that the issue of worker classification is an ongoing area of legal dispute and debate.

One such case is *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018), in which the California Supreme Court established a new standard for determining whether a worker is an employee or an independent contractor for purposes of wage and hour laws. Under the "ABC test," a worker is considered an employee unless the hiring entity can demonstrate that the worker is free from the control and direction of the hiring entity, performs work that is outside the usual course of the hiring entity's business, and is customarily engaged in an independently established trade, occupation, or business.

Another notable case is *Murphy Oil USA, Inc. v. National Labor Relations Board* (2007), in which the Supreme Court of the United States considered whether a company could be held liable for labor law violations committed by its independent contractors. The court held that companies can be held liable for unfair labor practices committed by independent contractors if the contractors have an "economic dependence" on the company.

In both cases, the courts considered various factors in determining whether a worker should be classified as an employee or an independent contractor, including the degree of control exercised by the hiring entity, the worker's skill and expertise, the nature of the work being performed, and the worker's level of independence and entrepreneurial opportunity.

Regarding volunteer firefighters and independent contractors, there have also been several cases. In *Mendel v. Gibraltar 6th Circuit Court of Appeals*, No. 12-1231 (New Hampshire Municipal Association, 2013), the U.S. Court of Appeals for the Sixth Circuit addressed whether “volunteer” firefighters are “employees” for purposes of two federal laws. The Court found that volunteer firefighters who were paid $15/hour when they responded to calls were “employees” under the FLSA.

There have been several lawsuits filed against Lyft and Uber alleging that they have misclassified their drivers as independent contractors instead of employees, while wrongfully withholding part of their salaries or deducting bogus fees from their earned wages (Katersky, 2023). This classification has important legal implications, as employees are entitled to a range of benefits and protections that independent contractors are not.

One such lawsuit, *O'Connor v. Uber Technologies, Inc*. (2019), was filed in California in 2013 by several drivers who claimed that they were misclassified as independent contractors and were, therefore, denied the benefits and protections of employment law. The United States District Court held that the drivers were presumptive employees of Uber, not independent contractors, because the drivers performed a service for Uber, and Uber depended on its drivers' performance of services for its revenues (CBS KCAL News, 2023).

Of course, any violation of the law, including unintentional ones, is likely to be costly for an organization. Recently, after being accused of illegally misclassifying employees as independent contractors and withholding money from over 100,000 drivers’ wages, Uber settled a case by agreeing to pay $290 million as a final settlement amount. Similarly, Lyft agreed to pay $38 million to settle the largest “wage-theft” settlement case in New York. (Katersky, 2023). Often, issues of unintentional violation arise from poor record-keeping procedures.

**Record-Keeping**

Organizations operating in the United States and their human resource departments are required by law to keep track of all records about their workers’ hours worked, wages paid, and

 other demographic data mandated by the Department of Labor. According to Ercanbrack (2023, para. 1), mistakes regarding the required documentation can cost organizations around $2,500 per violation. This can lead to large liabilities. For example, one company was recently fined over $1.5 million. If the organization is audited or brought to court by a current or former employee, the managers are to be able to provide documentation for all the required information demanded by the DOL.

In general, human resources personnel in each organization should maintain a checklist (Mujtaba & Meyer, 2022), as well as all the data and information for 3-7 years regarding the following (**Marrero & Wydler, 2023**):

* Personal information such as mailing address, birth date, government-provided identification, etc., on each employee
* Hours worked each workday and each workweek
* Total workweek straight-time earnings
* Hourly pay rate, raises, and bonuses provided
* Overtime payments for the workweek
* Deductions from or additions to wages
* Total wages paid each pay period
* Date workweek commenced
* Date of payment and pay period covered.

As mentioned previously, the FLSA requires that the record of work hours and wages paid to employees be maintained for a minimum of three years. However, while the time requirements for how long to keep important files on workers can vary based on the document type as well as local or state laws, human resources experts generally recommend a seven-year rule for record keeping (Ercanbrack, 2023). Documents such as the initial job announcement, resumes, references, background checks, notes from the initial interview, questions asked during the selection process, drug test results, etc., should be kept for a period of two-three years to review and ensure that hiring decisions are fair and non-discriminatory. Additionally, managers and human resource departments should keep track of each employee’s job titles, promotions, training programs completed, certifications earned, performance evaluations, leaves of absence, transfers, disciplinary activities, and termination information.

Record-keeping is important to demonstrate compliance with FLSA requirements and for continuous improvement purposes. For different categories of exempt and nonexempt employees, record-keeping requirements can vary since exempt employees, such as managers, may not have a limited number of hours each week as they are responsible for the entire operation and can come and go as appropriate (**Marrero & Wydler, 2023).**

The discussion of the provisions of the FLSA presented above illustrates the importance of HR professionals being aware of their organization’s compliance with federal and state wage and hour legislation while maintaining all necessary documents should the organization be audited. In the following section, we will discuss the importance of performing an audit within an organization to ensure compliance with the FLSA. We will also suggest a structure for such an audit.

**Performing a Wage and Hourly Audit**

**Rationale for an Audit**

In today’s workplace, companies are very competitive for diverse talent. The best way to keep track of employee turnover intention (leaving or staying) is to regularly survey workers to determine their sentiments and levels of satisfaction. An audit can identify how employees feel about their wages and benefits and their potential impact on their continued employment. As an example, Salesforce has been a world leader in auditing for pay differentials based on gender since 2015. They audit for equal pay every year and adjust employees’ compensation as needed (Hyder, 2022). Salesforce reported that,

Today, we’ve completed our latest fiscal year compensation review, and with it our seventh equal pay assessment of nearly 70,000 global employees at the time of the audit. Our analysis found 8.5% of our global employees required adjustments. Of those, 92% were based on gender globally, and 8% were based on race or ethnicity in the U.S. As a result, we spent $5.6 million to address any unexplained differences in pay, a total of more than $22 million spent since 2015 (Hyder, 2022, para. 4).

Audits can also reveal the potential for lawsuits and claims involving employee pay and violations of wage and hour laws, which can be extremely costly and damage any organization’s reputation as an employer of choice (Mujtaba, 2022). According to Attorney Elizabeth Alvine (2019, para. 1), there is “a record increase in the number of wage and hour claims filed against employers,” as DOL “recovered a record $304 million in wages from employers for wage and hour law violations.” An internal audit of employee pay can help organizations manage the risk of litigation (Dobrich, Dranoff, & Maatman, 2002). Experts claim that “An internal audit (1) can uncover major sources of risk for correction and (2) if properly completed with legal counsel, can provide a complete or partial ‘good faith’ defense to wage and hour claims” (Alvine, 2019, para. 3). Of course, before implementing any audit or new initiatives regarding wages and benefits, it should be emphasized that the auditing personnel must work closely with and through the company’s legal department to protect the organization.

**Criteria for the Audit**

One way for HR professionals to ensure that their organization complies with FLSA regulations is to perform a compensation policy audit. The goal of the audit is to assess compliance with all applicable regulations and to see how various FLSA concepts can be applied in the work environment. Such an audit identifies best practices and unique ways that modern organizations are working to manage their wage and hour practices or how some firms are limiting their initiatives to legal compliance while others go above and beyond concerns with compliance to attract and retain top talent.

Auditors can brainstorm potential criteria that a team of consultants could use to evaluate the wage and hour practices of an organization on an annual basis. Initially, Mujtaba (2022) recommends asking such questions as:

1. What do the organization’s policies and website communicate about the mission of the organization and its commitment to employees, government, unions, stockholders, and the environment?
2. What do the organization’s pay policies and website communicate about wage and hour practices?
3. Do the benefits and work scheduling practices recognize the needs of all employees and contractors based on their age, gender, seniority, management rank, and exempt or non-exempt status?
4. Is the organization in full compliance with the FLSA standards? How are these outcomes measured?
5. What are the current organizational values and philosophies? Does the organization “walk its talk” in terms of living its stated values and policies regarding fair and competitive compensation?

The consultant team must develop appropriate and personalized criteria for the organization so they can use consistent criteria each year for the wage and hour practices being audited. As consultants and researchers, measuring the company’s performance against established criteria in the FLSA and local or state requirements is important. Of course, the established criteria should be updated as new information is discovered during research (interviews and observations) with the company stakeholders.

The team of consultants can develop additional criteria that address how well the organization recognizes and responds to the differing needs of its employees. Attracting and hiring the best employees is a good start, but retaining and keeping them productively employed may require much more than just having compliance with the Fair Labor Standards Act.

**Procedure for the Audit**

Specific procedures and steps taken might vary depending on whether internal or external teams are used for the audit. If the designated audit team is external, they might need more information and data regarding the company’s history, data records, and contact persons. However, internal teams would already know much of the historical trends. At a general level, the external consultant team, or internal HR professionals, can take the following preparatory steps to serve as a group of experts for completing the audit project on organizational wage and hour practices:

1. Review the Fair Labor Standards Act regulations and guidelines regarding the workforce. As a team, conduct as much research as possible with company executives and managers, as well as regarding state and local laws, before officially meeting with anyone in the firm about the actual project. Doing some homework will help the team begin by strategically asking the right questions.
2. Determine the established assessment and evaluation criteria for assessing the wage and hour practices of the organization. Try to be objective by asking the same pre-determined questions during each audit to determine if the organization should receive a grade of A (excellent), B (good), C (satisfactory or average), or D (below standard) for the wage and

hour practices audit. Of course, provide sufficient reasons for the grading of the organization and support it with objective information. In the absence of quantifiable objective data, auditors can use qualitative input gathered by surveying employees throughout the company. It is important to be consistent during each auditing period by collecting similar data for assessment and comparison purposes.

1. Prepare the structured interview questions and survey instrument for primary research with employees of the organization so the same questions can be asked annually in future audits. While it would be helpful to get input from all employees by asking everyone to complete the structured survey, a sample of different groups of workers in each department, division, or region of the company can work well, too, when the entire population cannot be engaged. Based on the company and industry requirements, possible questions can focus on such items as those in Table 3 for each of the four FLSA categories:

 **Table 3**

*Questions for an Annual Compensation Audit*

|  |  |
| --- | --- |
| **Questions for FLSA Requirements** | **Yes / No****Notes** |
| ***A. Minimum Wage:**** + - 1. Is every employee paid at least at the federal minimum wage level?
			2. Is every employee paid in alignment with the local city and state regulations?
 |  |
| ***B. Child Labor:**** + - 1. Are minors employed only for tasks they are allowed to do based on FLSA and OSHA requirements?
			2. Are minors scheduled in compliance with federal and local laws in each state?
			3. Have there been any minors that were injured on the job? If so, have we put strong policies in place to avoid such incidents in the future?
 |  |
| ***C. Overtime Pay:**** + - 1. Are the classifications of exempt and non-exempt employees correctly determined?
			2. Are employees paid properly for overtime hours and value-added tasks performed while they are on break, off the job, and/or travel time for work-related functions?
			3. Is there evidence that there is no discrimination in salaries, merit increases, promotions, or bonuses due to an employee’s race or sex?
			4. Based on the ABC Test, is there sufficient evidence that volunteers and contractors are correctly classified and paid in alignment with all applicable regulations?
 |  |
| ***D. Record-keeping:**** + - 1. Is there a record of all employees’ hours worked and wages paid for a minimum of three years?
			2. Are we keeping a record of the required documents for at least seven years?
 |  |

For a company that is considered a medium-sized firm (usually with 500 or more employees of different ages, ranks, and pay grades), the annual audit could include the general steps presented in Table 4 (Alvine, 2019; Mujtaba, 2022; Kun, Ruzal, & Sullivan, 2018; Jackson et al., 2017).

 **Table 4**

 *Wage and Hour Auditing Steps*

|  |  |
| --- | --- |
| **Steps** | **Tasks and Procedures** |
| 1. *Conduct surveys and/or interviews*
 | Send out the structured survey to the designated employees. While structured surveys do provide efficiency in the data collection process, qualitative interviews can also be effective in gaining deeper-level data when conducted by qualified professionals.  |
| 1. *Confirm the accuracy of job classifications.*
 | Tasks involved here would include scrutinizing job descriptions, duties being performed, qualifications being required for all the jobs, and making sure all exempt and non-exempt wages paid are in full compliance with FLSA. |
| 1. *Evaluate the wage and hour policies to make sure they are current, legal, fair, and in full compliance.*
 | The team should evaluate any changes to the FLSA laws that impact policies during this post-Covid-19 era. The FLSA allows some flexibility on the use of applicable technology in the industry, and firms should be using the most developed, safest, and most efficient tools possible to keep track of employees’ data and wages in the most secure manner possible. Experts should also review the posting of law requirements. The evaluation would be inclusive of the leave and Paid Time Off (PTO) policies to make sure each employee gets fairly paid in a timely manner. Legality can be evaluated to make sure there is no disparate impact on any protected group of employees. Fairness can be evaluated through distributive, procedural, and/or interactional outcomes.  |
| 1. *Review wage and hour regulations to make sure proper deductions are made from paychecks.*
 | Make sure that exempt employees receive the correct predetermined amount of compensation for every pay period regardless of how many hours they worked, or outcomes produced. In this step, make sure that everyone knows the Department of Labor's rules in the United States on the "white collar" exemptions from federal overtime and minimum wage requirements, as the FLSA provides a "safe harbor" that can maintain an employee's exempt status in case there are illegal or inaccurate payroll deductions. As such, as per the Safe Harbor policy and procedures, only proper and legally compliant payroll deductions should be made for all employees. |
| 1. *Review wage and hour regulations in the non-exempt category.*
 | The main tasks involved here are to make sure the firm pays non-exempt workers minimum wage and that any overtime worked hours are paid in accordance with applicable federal, state, and/or local laws. The auditors will need to confirm that they have analyzed and documented all payment calculations showing compliance with local, state, and federal laws. Like the previous years, confirm that all hours worked are properly recorded through a consistent and acceptable timekeeping process. |
| 1. *Determine compliance with child labor laws.*
 | The tasks involved here would be related to the working hours of those who are less than 18 years of age. If the company has hired eligible teenagers to work part-time, then make sure they are being paid fairly and that their work hours are in full compliance with FLSA expectations. All managers must know that the Child Labor Regulation (No. 3, 29 C.F.R.&570.35) limits both working hours and the time of the day when young people who are 14-15 years of age can work. These teenagers can only work after school hours, they can only work 3 hours on school days, no more than 8 hours on weekends and holidays, and no more than 18 hours per week when school is in session. Furthermore, one task may involve the recommendation of providing more information and training to all managers who are involved in the hiring and scheduling of employees so they can better understand child labor laws.  |
| 1. *Ensure record maintenance.*
 | Human resource professionals recommend keeping records of all employees’ hours worked, wages paid, overtime, promotions, bonuses, etc., for a period of three to seven years. So, ensure and confirm that all such records are maintained on a consistent basis. |

|  |  |
| --- | --- |
| 1. *Analyze the survey findings.*
 | Draw relevant conclusions supported by the data and debrief. |
| 1. *Fill any missing gaps.*
 | Find more information as needed or according to any existing gaps. |
| 1. *Finalize for management.*
 | Prepare a final report, including recommendations, for presentation to company officials and managers.  |

It is important to ensure that the classifications of exempt employees are correctly determined. Additionally, the auditing team should check annually to make sure there is no pay discrimination in salaries, merit increases, or bonuses based on protected categories such as race or sex since these are all important areas of FLSA compliance and the Office of Federal Contract Compliance Programs (OFCCP) requirements regarding pay.

At the conclusion of the audit, it is important that consultants develop a list of recommended actions that the organization can take to benefit from the existing or prospective wage and hour best practices. The auditors may conclude that the firm complies, or they may recommend that managers recruit additional legal assistance to implement relevant wage and hour policy and procedural changes so the organization can be in full conformity with the FLSA regulations through best practices which will assist in attracting, recruiting, and retaining top talent.

**Discussion and Limitations**

The focus of this paper was on the requirements put forth in the Fair Labor Standard Act and the measures that should be taken by employers to ensure compliance with these requirements. While the FLSA constitutes a very important part of compensation law, it is by no means the only area regarding compensation where employers should ensure compliance. Further papers should include a more comprehensive review of issues raised by the OFCCP and the Civil Rights Acts (Equal Pay Act of 1963, the Civil Rights Act of 1964, and the Lily Ledbetter Fair Pay Act of 2009). Requirements based on these laws should be seriously considered when considering undertaking a compensation audit.

**Conclusion**

It is a fact that “wage and hour mistakes continue to be one of the costliest errors for employers, and the number of wage claims continues to rise” (Alvine, 2019, para. 18). These mistakes have resulted in numerous legal agencies, many with costly results for the organizations involved. Managers and human resources professionals must avoid such costly errors by understanding the laws and making sure that everyone is paid fairly so they can remain competitive in their respective industries. As such, an annual audit provides an opportunity to review pay practices and identify areas of concern to minimize wage claim risks. It also provides the opportunity for organizations to improve their payroll policies and work-hours recordkeeping procedures. The primary goal of the audit is to conduct a comprehensive and in-depth review of employee pay, record-keeping practices, and payroll policies to screen for any possible wage and hour inaccuracies.

In the modern post-COVID-19 world, tech-savvy employees are likely to be more aware of FLSA and state regulations (Smith, 2022). For this reason, all managers and human resources professionals should receive comprehensive training on employment laws as well as compensation laws at the federal, state, and local levels.

Managers and human resources professionals must understand that all companies in the United States are required to keep their employers’ wages and hours records for at least three to seven years. Furthermore, these professionals must know the FLSA regulations (and applicable local and state laws) that are relevant to their firms and industries. When a company’s wage and hours practices are in full compliance with the FLSA and state requirements, the organization is likely to avoid costly lawsuits, which can come with significant financial and reputational costs. The goal of any wage and hour audit undertaking should be to make sure that the entire organization’s pay policies and procedures are in full compliance with federal legal standards, state laws, and local expectations so that a satisfied and productive workforce can be maintained.

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