

LEADING AN HR AUDIT: ASSESSING EMPLOYMENT RISKS

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ABSTRACT

Employers conduct human resource (HR) or employment audits for a variety of reasons. Primarily, employers conduct periodic employment audits as a proactive measure to ensure that their policies and practices are in compliance with applicable federal, state, and local laws. Employers that utilize counsel to help their organization conduct the audit find employment audits to be particularly beneficial. Counsel who are knowledgeable about labor and employment laws and keep abreast of the latest legal developments will be in the best position to scrutinize and assess the legality of an employer's existing policies and practices. Well-informed counsel can also assist employers in utilizing best practices, which could prove crucial to these employers' goal of remaining competitive in their respective fields. Further, appointing counsel to direct an audit will ensure that the employer will be better able to respond to litigation or threatened litigation and other inquiries. Most significantly, without counsel's involvement, the employer has little hope of shielding either the information developed during the audit or the results from discovery.

Employers conduct wage and hour classification audits for two primary purposes: (1) to analyze whether workers are properly classified as independent contractors instead of employees and (2) to analyze whether employees are properly classified as exempt instead of nonexempt, overtime-eligible employees under the Fair Labor Standards Act and similar state laws. In recent years, both federal and state governments have taken unprecedented actions to enforce wage and hour classification laws. Private litigation of wage and hour complaints, in particular class and collective actions, has also increased dramatically. Before commencing a classification audit, the employer and its counsel should first identify the groups (consultants, freelancers, contractors, and employees) and positions to audit. The employer and its counsel should also collect payroll information regarding the specific positions audited and should familiarize themselves with the applicable legal classification test. Application of these fact-specific tests depends on the jurisdiction and the type of claim asserted. In the event that the audit findings reveal a misclassification issue, counsel should check the employer's benefit plans, help calculate costs, evaluate the potential for litigation, and work with the employer to assess employee morale issues prior to implementing any changes.

FULL TEXT

Employers conduct human resource (HR) or employment audits for a variety of reasons. Primarily, employers conduct periodic employment audits as a proactive measure to ensure that their policies and practices are in compliance with applicable federal, state, and local laws. Employers that utilize counsel to help their organization conduct the audit find employment audits to be particularly beneficial. Counsel who are knowledgeable about labor and employment laws and keep abreast of the latest legal developments will be in the best position to scrutinize and assess the legality of an employer's existing policies and practices. Well-informed counsel can also assist employers in utilizing best practices, which could prove crucial to these employers' goal of remaining competitive in their respective fields. Further, appointing counsel to direct an audit will ensure that the employer will be better able to respond to litigation or threatened litigation and other inquiries. Most significantly, without

counsel's involvement, the employer has little hope of shielding either the information developed during the audit or the results from discovery.

This article addresses two issues employers should consider when determining whether to initiate an audit: (1) the steps counsel can take to help an employer control disclosure of an audit's contents and findings and (2) the kinds of audits an employer should consider conducting.

Disclosure issues affecting audits. Employers often resist conducting HR audits because of concerns that the results will be used against them in litigation or a government investigation.

Whether the attorney-client privilege applies to an audit often depends on why the employer conducted the audit. If the audit is being conducted to provide legal advice, it is likely protected by the privilege. By contrast, if the audit is being conducted for purely business purposes, it will not be protected by the privilege.

The attorney work-product doctrine may apply to an audit if the employer conducts the audit because there is a likelihood of litigation. First, as with attorney-client privilege, the central inquiry is whether the material is prepared for legal purposes or for ordinary business purposes. Second, courts evaluate whether the materials are prepared "in anticipation of litigation." A majority of federal circuits answer this question by evaluating whether materials were prepared or obtained "because of" an objectively reasonable prospect of litigation.

In addition to the measures employers can take to protect materials under the attorney-client privilege, two additional steps may help protect materials under the work-product doctrine: (1) counsel should be involved from the beginning of the audit, specifying that the audit is being performed in response to litigation or anticipated litigation, and (2) counsel or people designated as agents to counsel should prepare the materials as part of the audit.

A final privilege that employers may assert to prevent discovery of audit materials is the self-evaluation privilege. The employer must show the following to establish the privilege: (1) the information sought must be the result of a critical self-analysis undertaken by the party seeking protection, (2) there must be a strong public interest in preserving the free flow of the type of information sought, (3) the information sought must be of the type whose flow would be curtailed if discovery were permitted, (4) the information sought must have been prepared with the expectation that it would be kept confidential, and (5) the information sought must be a subjective analysis designed to have a positive societal effect.

Conducting the audit. The three most common types of employer-initiated audits are (1) an equal employment opportunity (EEO) audit, (2) a pay equity audit, and (3) a wage and hour classification audit.

In conducting an EEO audit, counsel should review the employer's handbook, code of conduct, and any stand-alone policies to determine whether the employer has in place all the legally required anti-discrimination, anti-harassment, anti-retaliation, and compliance policies and procedures, and to determine whether such policies are consistent with current federal, state, and local laws. The audit should also include an examination of recruitment and hiring policies and procedures. Counsel should also examine the employer's discipline, complaint, and involuntary termination procedures.

Employers perform pay equity audits to ensure fairness in pay rates among similarly situated employees and to confirm that an employer's written policies are consistent with the factors influencing compensation. Counsel should engage and work closely with a qualified statistician to ensure that analysis of the data is sound. Working with a qualified statistician will maximize the reliability and usefulness of the audit results. In preparation for conducting a pay audit, counsel should identify and review job-related and productivity-related factors and consider whether the compensation variables are universal across the organization or whether they differ by business unit, geographic location, or other factors. The common mistakes that experts make when analyzing an employer's wage rates include improperly aggregating the employee population and omitting important neutral variables that influence employee pay. Therefore, the more accurately employers and their counsel can identify and understand the variables affecting compensation before conducting the audit, the more effectively they will be able to focus on such factors during the audit and meaningfully use the results.

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are properly classified as independent contractors instead of employees and (2) to analyze whether employees are properly classified as exempt instead of nonexempt, overtime-eligible employees under the Fair Labor Standards Act and similar state laws. In recent years, both federal and state governments have taken unprecedented actions to enforce wage and hour classification laws. Private litigation of wage and hour complaints, in particular class and collective actions, has also increased dramatically. Before commencing a classification audit, the employer and its counsel should first identify the groups (consultants, freelancers, contractors, and employees) and positions to audit. The employer and its counsel should also collect payroll information regarding the specific positions audited and should familiarize themselves with the applicable legal classification test. Application of these fact-specific tests depends on the jurisdiction and the type of claim asserted. In the event that the audit findings reveal a misclassification issue, counsel should check the employer's benefit plans, help calculate costs, evaluate the potential for litigation, and work with the employer to assess employee morale issues prior to implementing any changes.

Next steps after an audit. An audit report should document the process and findings of the audit, detailing the strengths and weaknesses of the results. Counsel should advise the employer on what steps it should take in response to the audit's findings. When an employer takes action in response to an audit or determines that, as a result of an audit, change is not necessary, it becomes particularly critical for an employer to maintain documentation of the audit process, its findings, and any changes implemented. *

Sidebar

WHY THE EMPLOYER CONDUCTS AN AUDIT MAY DETERMINE WHETHER ATTORNEY-CLIENT PRIVILEGE APPLIES.

Sidebar

ABA SECTION OF LABOR AND EMPLOYMENT LAW

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