



Are You Prepared for a Department of Labor Audit?

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*Little Mendelson
San Francisco, CA*

The word “audit” makes most Payroll and Business Managers squirm in their seats. The idea of a government auditor checking for dust under the rug is daunting – regardless of whether someone swept it there or it settled on its own. The cost of FLSA infringement is high, and with ACA penalties to be careful of, a passive approach to audit preparation will only lead to trouble.

Across the nation, school districts are scrambling to validate their compliance with FLSA and ACA standards in preparation for potential Department of Labor (DOL) audits, and according to Littler Mendelson, a San Francisco-based law firm, the frequency and reach of these audits are growing.

“The Department of Labor is conducting more audits with more staff and is now auditing more aggressively by seeking double damages and civil money penalties in circumstances where never previously pursued. Even seemingly casual employee complaints to the DOL are taken seriously for audit purposes.”¹

This trend implies a lot in terms reporting requirements for school districts. Pete Isberg of the American Payroll Association says, “In a sense, handling any actual IRS notices will be a minor task in comparison to the many new calculations, record-keeping, and reporting requirements that employers will be obligated to perform.”² In fact, a study published by Littler Mendelson revealed that the number of wage-hour lawsuits increased 500% from 2001 to 2012.³ According to a NERA Economic Consulting study of wage-hour settlements, employers paid out a total of \$2.7 billion between 2007 and 2012, and \$467 million of that was in 2012 alone.⁴

The DOL does not go lightly, and school districts cannot ignore numbers like these. With the DOL raising the bar on wage and hour requirements, how can school districts achieve audit preparedness? A great place to start is understanding what a DOL audit will look like, what will happen if your district fails, and what you need to do to prepare.


What does a Department of Labor audit look like?

The auditor's job is to ensure that employees are being paid according to FLSA regulations, as well as other federal and state laws, and that any workers under 18 are being paid according to child labor provisions. In order to evaluate whether you're meeting these terms, you may be audited without even receiving notification.

According to the official DOL website, "The WHD [Wage and Hour Division] does not require an investigator to previously announce the scheduling of an investigation, although in many instances the investigator will advise an employer prior to opening the investigation. The investigator has sufficient latitude to initiate unannounced investigations in many cases in order to directly observe normal business operations and develop factual information quickly."⁵ Typically, however, the auditor will give you notice of an impending audit, usually two to three weeks to gather the requested files.

When the audit does take place, the auditor can and likely will come onsite and inspect district property and practices, question employees about the nature of their work and pay, and review the requested records in order to determine whether any violations of FLSA, ACA or any other provisions have occurred. The requested records often cover random groups of employees for a set date range between one to three years, and may include records from the last seven years. The auditor may make a note of your ability to gather the requested records in the time-frame required. While you can request additional time, which would only be granted if the auditor accepts the reason for your request, telling the auditor that you don't have enough time to gather the records implies that you are not managing your records appropriately.

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Although they do occur randomly, most DOL audits take place in response to an employee complaint. In fact, some states even run commercials encouraging employees to file complaints. The employee does not need to provide substantial evidence backing their claim, but can file a complaint due to just a feeling of unfair pay. While filing a complaint does not guarantee the district will owe the employee any back pay, the DOL sides with employees in the majority of audits. In either case, the employee is protected by the FLSA; according to the DOL's FLSA Advisor, "It is a violation to fire or in any other manner discriminate against an employee for filing a complaint or for participating in a legal proceeding under the FLSA."⁶

The records required by the auditor may include:

- A list of random employees and their job descriptions (to evaluate exemption status)
- I-9s, to make sure employees are working legally
- Payroll Ledgers (which detail hours paid, OT, CT, etc. for hourly and annualized employees)
- "Worked Time" (your timesheets that detail clock in/out times)
- Approval History (the records of who approved what timesheets)
- State Wage Reports

What happens if my district fails?

After fully evaluating your records, your auditor will send an official letter stating whether you've passed or failed, as well as any reparations that you'll need to make if you do fail. What exactly your punishments could look like will vary depending on the context of your infringement. If ten "exempt" employees complain that they ought to have received overtime pay for the last two years and the auditor confirms this complaint, you'll need provide back pay, under the supervision of the WHD, for those ten

employees for those two years and pay an equal amount as liquidated damages, plus any attorney and court fees.

Obviously you could incur crippling fines depending on the scope of your infringement. And in the worst of situations, where violations were knowingly incurred, the DOL has stated that “willful violations may be prosecuted criminally and the violator fined up to \$10,000. A second conviction may result in imprisonment.”

The DOL has listed the methods made available by FLSA for recovering unpaid wages:

1. WHD may supervise payment of back wages.
2. The Secretary of Labor may bring suit for back wages and an equal amount as liquidated damages.
3. An employee may file a private suit for back pay and an equal amount as liquidated damages, plus attorney’s fees and court costs.
4. The Secretary of Labor may obtain an injunction to restrain any person from violating the FLSA, including the unlawful withholding of proper minimum wage and overtime pay.

The DOL has placed a statute of limitations on how much back pay you could be liable to provide: up to two years in most cases, but up to three years if willful violation has taken place. However, like most standards, state regulations can and often do override national regulations, raising them to more stringent standards. The general consensus is that all employers should maintain their records for at least seven years. Make sure you familiarize yourself with your state regulations and how they differ from those set by the DOL.

Upon making reparations, you must prepare a written response explaining how the errors occurred, how they were rectified and proving that they were rectified, then wait for final approval by the WHD.

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How do I prepare my district for an audit?

Validate Your Classifications

The first step to ensuring compliance (and a smooth audit) is to validate the classification of your employees. One of the first things the auditor will do is evaluate whether you've correctly classified your employees, and many employers have failed DOL audits due to improper classification.

Classifying an employee as exempt from overtime simply because they're paid on a salary basis is not compliant with FLSA regulations. The Wage and Hour Division has outlined very specific standards as to what constitutes an employee as exempt. If an employee that you've classified as exempt files a complaint that he or she ought to be receiving overtime compensation, the auditor will often side with the employee, forcing you to provide back pay to the employee and potentially to pay fines for failing compliance.

Consult Fact Sheet #17A on the DOL website for a detailed list of criteria necessary for classifying different types of employees.⁷

Organize Your Records

Another key requirement to preparing for an audit is making sure you're storing the required information, and that it is accessible if the auditor requests it. The DOL has provided a list of records to be kept by employers:

1. Employee's full name and social security number.
2. Address, including zip code.
3. Birth date, if younger than 19.
4. Sex and occupation.
5. Time and day of week when employee's workweek begins.
6. Hours worked each day.
7. Total hours worked each workweek.

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8. Basis on which employee's wages are paid (e.g., "\$9 per hour," "\$440 a week," "piecework")
9. Regular hourly pay rate.
10. Total daily or weekly straight-time earnings.
11. Total overtime earnings for the workweek.
12. All additions to or deductions from the employee's wages.
13. Total wages paid each pay period.
14. Date of payment and the pay period covered by the payment.

Make sure you never offer the original records to the auditor. Instead, give them a copy. They may keep any records you give them.

Complete, clean, organized records – whether printed or on the web – make all the difference in a successful audit; your records need to defend themselves because you might not get a chance to explain them yourself.

Improve Your Time and Attendance Tracking

Obviously, several items from the list above require a timekeeping process. The DOL does not stipulate what method you use, as long as you're storing accurate and complete information. However, keeping accurate and complete information – much less accessible information – is easier said than done. Inconsistent and erroneous records are rife in school districts, especially those still using a paper-based time and attendance tracking process. Paper timesheets make validating your employees' time worked nearly impossible, and gathering those timesheets from each location across your district can be a nightmare.

Cary Herring, Payroll Specialist from Montgomery ISD, said this about her prior, paper-based process: "If you had to pull from past time, you didn't know where the [former] payroll person had put the timesheets. You have secretaries at different locations figuring out time; some of them are rounding, some of them are not rounding – you have very inconsistent figuring of the time. . . . When we've tried to go back and find things from prior times, there were some times you couldn't find them."

That's why Montgomery ISD switched to a web-based time and attendance program to track and manage their records. "With [the web-based

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program], everything was set – you have control of it,” Ms. Herring said. “We knew everything was very consistent – there are no messes there.”

A time and attendance system will also automate how *overtime* – the biggest FLSA offender – is tracked and applied. It’s best to avoid having secretaries or payroll specialists figuring work weeks and manually calculating overtime totals, then hand-keying that data into your payroll system; that process is error-prone and consumes a disproportionate amount of time. Web-based time and attendance software increases the accountability and accuracy of your timekeeping process by clocking the actual time employees have worked, calculating those hours with the relevant payroll rules and automatically entering that time into your payroll system. In addition, it centralizes all of your information so that it is accessible immediately.


The DOL permits you to keep records of worked time for all employees, regardless of classification. Unfortunately, many districts fail in this section of their audit, even with an accurate time and attendance system, because they don’t track worked time for any annualized employees. While not required by the FLSA, recording annualized employees’ timesheets becomes especially important if the auditor is reevaluating your classification of an employee, as mentioned above. Even setting up automatically rolling timesheets with annualized employees’ scheduled hours recorded will suffice, as long as leave, special events and extra time are recorded.

Of course, if you’re working with a union that has specific regulations about tracking employees’ time, you will need to defer to those standards.

Track Hours for the Affordable Care Act

In addition to FLSA compliance, districts now need to be prepared for audits for compliance with the Affordable Care Act (ACA). “Large” employers are required to provide health coverage to all full-time employees and their dependents, or face a penalty. What constitutes a “large” employer? Any employer with 50 or more full time employees, *including FTEs*, qualifies as a “large” employer. But even smaller districts are still required to track employee hours for record purposes.

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Most districts have decided to manage their part-time employees and substitutes in order to keep them under the full-time average. A detailed and organized time and attendance program will be necessary to achieve this, as well as to prove to an auditor the status of your employees.

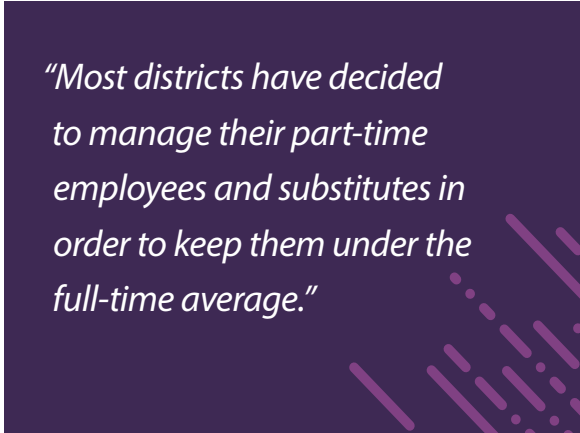
Full-Time Equivalent (FTE)

A full-time employee is any employee working an average of more than 30 hours a week or 130 hours a month. Part-time employee hours also count toward your total number of full-time employees: you add up the total hours worked in a month by part-time (under 30 hours) employees and divide by 120 to get a “Full-Time Equivalent” count to add toward your total. FTEs count when determining your “large employer” status but do not count toward any penalties.

Look-Back Measurement Method

To determine whether a part-time employee qualifies for benefits, districts can choose a 3 to 12 month “look-back period.” If the average hours worked in this “measurement period” come to 30 or more per week or 130 or more per month, the employee is eligible for benefits in the next “stability period.” For a full list of the regulations and penalties associated with the ACA, see our [blog post](#) in our [ACA Resource Center](#).⁸

So what do you need to be doing now to prepare? Make sure your time and attendance program allows you to track and report on worked time over flexible date ranges – especially for your substitutes. In fact, a report built specifically for monitoring part-time worker hours in relation to ACA qualifications would allow you to take a proactive approach to managing your workers’ time and benefits.



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Don't Wait to be Audited

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Finally, one of the best ways to prepare yourself for an audit is to perform regular, voluntary audits. (In fact, regular audits may be required. Familiarize yourself with your state regulations and how they override or supplement federal regulations.) Many school districts hire outside auditors to evaluate their processes annually or biannually.

These audits go a long way in validating compliance and preventing fines potentially incurred during a surprise DOL audit. Not only will regular audits verify the legality of your classifications, payment and practices, but the overall experience of the audit will confirm whether you're managing your records in a reliable and efficient way.

After experiencing several voluntary audits, then transitioning to a web-based time and attendance program, Cary Herring said, “It does affect a lot of people. [Before] it took maybe eight hours to pull the documentation. This last time it was very quick. It probably took an hour this time.” Cary mentioned that those 8 hours it took previously were only for her, and did not include the additional time spent in the HR and Finance departments..

Work through the DOL's FLSA assessment tool to validate your district's compliance.⁹ This tool serves as a good preliminary assessment of compliance for employers who are unsure whether compliance to their state and local government regulations translates to compliance to the FLSA. If you answer “yes” to any of the questions in the tool, you may be violating FLSA regulations and are in danger of failing a DOL audit.

Grooming your practices through self-audits can ultimately save you a lot of time and money.

Conclusion

Especially with the FLSA and ACA, audits are on the rise. School districts need to act now to prepare themselves for the coming years. If you checked your mail this morning and found a report from the Department of Labor, would you be confident in your processes, or would your gut sink because it would already be too late? Don't be one of the many school districts that are unsure of their compliance in the face of a DOL audit.

"DOL audits are lengthy and awful and a nightmare. That's one of the reasons we looked at doing all this [switching to a web-based time and attendance program and performing voluntary audits]. We want to be as prepared as possible, so that we have everything nice and clean; you can see exactly where we are. We want to be an open book." - Cary Herring, Payroll Specialist, Montgomery ISD

Footnotes:

- ¹ <http://www.littler.com/events/navigating-wage-and-hour-audits-todays-empowered-department-labor>
- ² <http://info.americanpayroll.org/pdfs/publications/paytech-sample.pdf>
- ³ <http://www.lb7.uscourts.gov/documents/12-19431.pdf>
- ⁴ <http://www.nera.com/news-events/press-releases/2013/nera-economic-consulting-releases-wage-and-hour-settlements-tren.html>
- ⁵ <http://www.dol.gov/whd/regs/compliance/whdfs44.html>
- ⁶ <http://www.dol.gov/elaws/esa/flsa/screen74.asp>
- ⁷ http://www.dol.gov/whd/regs/compliance/fairpay/fs17a_overview.htm
- ⁸ http://www.frontline12.com/Pages/ACA_Resource_Page.html
- ⁹ <http://www.dol.gov/whd/StateandLocalGovernment/media/SelfAssessmentTool-CountyGovernmentfinal071906.htm>



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