Steering Clear of
FLSA Compensation Violations

The Three Most Common FLSA Blunders By Employers — And Your Best Bets For Helping Keep Your Organization Compliant

In business, as in life, mistakes can have a certain value. But that doesn’t mean they can’t still be costly — especially if we don’t learn from them.

Nowhere is that advice more apt than when dealing with federal regulations such as the Fair Labor Standards Act (FLSA), which governs the rules for such areas as minimum wage, overtime pay, recordkeeping and youth employment standards.

Across multiple industries, it’s common to see the same FLSA violations being committed time and again, according to a recent research paper by Vicki Lambert, CPP, President of Lambert and Associates, a firm specializing in payroll training.

According to Lambert, companies most commonly go astray in three major areas:

- classifying employees as exempt or nonexempt
- counting the number of hours worked
- calculating overtime pay

On the surface, these three areas seem surprisingly simple. How could you possibly miscount the number of hours an employee has worked? In reality, getting it right is not so easy — and not so cheap if you get it wrong.

Tasked with enforcing the provisions of the FLSA is the Wage and Hour Division (WHD) of the U.S. Department of Labor — not exactly an agency you’d like to see knocking at your office door. In 2008, the WHD recouped an estimated $185 million in back wages — and in the process, assessed employers over $3 million in civil penalties for overtime and minimum-wage violations.

The Classification Conundrum: Contractor or Employee?

Misclassification of an employee as an independent contractor can have serious implications for your bottom line. The IRS can reclassify independent contractors as W-2 employees, resulting in the imposition of fines, penalties and back taxes for which the employer is generally liable. Typically, an employer must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors. According to the IRS, businesses must weigh factors like these to correctly classify service providers:

- **Behavioral** — Does the company control what the worker does and how?
- **Financial** — Are the business aspects of the worker’s job controlled by the payer? Consider how the worker is paid, whether expenses are reimbursed and who provides tools or supplies.
- **Type of Relationship** — Are there written contracts or employee-type benefits? Is the work performed a key aspect of the business?

Correct classification requires looking at the entire relationship, considering the degree or extent of the right to direct and control, and documenting in detail the factors used to make your decision.
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Be alert to common compliance pitfalls to avoid contributing to the WHD coffers this year, re-examine your processes to ensure you’re remaining compliant in these major areas:

1. **Exempt vs. nonexempt employees** - The FLSA requires that all employees be paid at least the federal minimum wage for all hours worked and time and a half their regular rate of pay beyond 40 hours in a workweek, unless specifically exempted.

   These exemptions include (but are not limited to) bona fide executive, administrative, professional and outside sales employees. It’s important to note that job titles alone do not determine exempt status. To qualify for exempt status, employees must generally pass three tests: job duties, salary level and salary basis. In order for an exemption to apply, an employee’s specific job duties, salary amount and how that salary is paid must meet all the requirements of the Department of Labor’s regulations.

2. **Accurately counting the number of hours worked** - Employees must be paid for all hours worked. Sounds simple enough, right?

   Unfortunately, the FLSA does not provide a clear definition for hours worked. In several U.S. Supreme Court rulings, hours worked may include any time spent in physical or mental exertion that is controlled or required by the employer and all hours an employee is required to give to an employer. This may include waiting time if it is for the employer’s benefit, and all the time during a workweek that an employee is required to be on the employer’s premises.

   These circumstances might also be considered hours worked:
   - on-call time
   - attendance at meetings or lectures
   - travel time

3. **Calculation of overtime pay** - Many employers believe overtime is calculated using the employee’s hourly rate and multiplying it by 1.5 and the number of overtime hours. If no other factors beyond straight and overtime hours are involved, that would be absolutely correct.

   However, if the employee’s regular rate of pay includes items such as shift differentials, nondiscretionary bonus or a cost-of-living adjustment, this calculation can become infinitely more complex. Employers must then determine on a case-by-case basis if these additional payments are included in the regular rate of pay, in order to calculate overtime correctly.

**The Challenge Facing Employers – And the Case For Calling In HR Experts**

Today’s business environment has made understanding the latest FLSA requirements extremely important in order to stay compliant while meeting your organization’s HR needs.
More and more companies are deciding that this growing compliance burden is too much to handle on their own and are turning to outside HR experts for support and guidance. HR compliance – not just FLSA – in today’s workplace requires consultation, communication and a proactive approach to training managers and supervisors on compliance essentials. The most effective compliance efforts are planned, implemented, tracked and communicated in such a way that potential problems are identified and handled before they become major issues.

Of course, the FLSA covers much more ground than just the three areas outlined above. But understanding the dynamics — and the ramifications — of the three most common violations will give your organization a head start in avoiding inadvertent and expensive contributions to the DOL. And getting compliance guidance from HR experts when you find the compliance burden too much to manage on your own is a smart investment.

By deciding to partner with ADP Resource, your company has access to a seasoned HR Business Partner that can assist your organization in understanding the twists and turns of FLSA compliance. If you have questions regarding FLSA please feel free to contact your HR Business Partner.