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Pay Equity Audits as a Risk Identification Tool: Part II

Employers faced with navigating the wave of new and potential legislation directed at remediating pay equity issues would be wise to proactively to address the issue.

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Employers faced with navigating the wave of new and potential legislation directed at remediating pay equity issues would be wise to proactively to address the issue. While it may seem obvious, none of the applicable laws prohibit pay differentials outright; instead, all laws prohibit pay differentials only when they are attributable to impermissible factors. A properly structured pay equity audit can serve to identify only those differentials that are potentially unlawful, and tacitly approve of those differentials that are permissible.

Each employer may have different goals for an audit, different ideas concerning the appropriate focus of the audit, and different resources to be contributed to the audit, all of which prevent a "one size fits all" approach to describing an audit. Nevertheless, five features will be integral across all efforts.

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First, and perhaps most critical, is a planning and strategy session during which the employer and inside or outside legal counsel can map the audit. It will be critical for the auditor to gain an understanding of the employer's business as a general matter, and as a specific matter, any unique considerations relevant to the employer's compensation systems, practices and philosophies. Are advanced degrees, for instance, prioritized over length of service? Does the employer favor a lockstep compensation approach over a merit-based system? Answers to these questions will be necessary to identify pay differentials that deviate from expected results and which may, therefore, be areas of concern.

In addition to these contextual and ideological matters, the planning session will allow the employer and the auditor to set the scope of the audit, whether it be companywide, a division thereof, or a lone job title. The planning session will also serve to identify points of contact at the employer organization who will partner with the auditor, and allow the parties to set a budget, timeline, and schedule for updates. The meeting will also allow for a discussion of how best to conduct the audit under the protection of the attorney-client privilege.

Second, is gathering the data. An effective audit that accounts both for compensation differentials as well as controls and other potential explanations for any inequities requires both "hard" and "soft" data. Hard data will consist of the specific compensation data that will allow the auditor to capture the total earnings of a given employee over a predetermined timeframe. Thus, the hourly wages, overtime wages, and hours worked, in the case of nonexempt employees, and base salary, in the case of exempt employees or salaried nonexempt employees, will be necessary. Discretionary and non-discretionary bonuses, equity awards, grants, and dividends and other forms of supplemental compensation will be necessary as well. "Soft" data will consist of information that will paint the picture of each employee. Age, years of service, business unit or department, functional and corporate titles, location, and, of course, gender or other demographic to be analyzed as part of the audit. The integrity of this process is paramount as the adage "garbage in, garbage out" applies firmly.

Third, is the preliminary analysis of the compensation data among properly comparable groups. Identification of the right persons for comparison will be informed by both logical considerations as well as the legal requirements for the jurisdiction within which the audit is performed. As to the former, in a law firm for example, little purpose would be served in evaluating the compensation of paralegals versus attorneys. Instead, the comparison must be among persons doing similar work based on skill effort or accountability. As to the latter, federal law suggests that the comparison be limited to workers in a single establishment, whereas some states, like California, require consideration of workers (performing functionally similar roles) across the entire state. Whatever grouping the employer and auditor determine is appropriate, the goal of the analysis at this stage is the same: identification of any pay gaps that are not random and are statistically significant under generally accepted statistical models such that further investigation is warranted.

Fourth, as to these "hot spots," the employer and auditor must work together to identify any objective, nongender-based (or other demographic) factors that legitimately account for the identified pay differentials. Length of service may be fully explanatory for one employer, whereas another, such as a software development company that has a particularly young workforce, may not consider it all such that it does not account for the differential. Other potential explanatory factors, but by no means exhaustive, include location, education, years of experience, production targets, performance evaluations, or grade. Interviews with supervisors may also be necessary to understand nuances between the roles of two employees who work in the same location and share the same duties who are, otherwise, ostensibly comparable.

These efforts should narrow the number of employees (or job functions) for which pay disparities exist that are not explainable by nongender-based criteria. These remaining groups will likely warrant remediation measures, the fifth and final feature of a pay equity audit, which will be discussed in Part III of this series.

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