

# HR 101: Compliance Audit

A **Nonprofit HR** White Paper

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## HR Audit: 101

### Introduction

Do you lie awake at night thinking about questions such as:

- Is my organization in compliance with federal and state guidelines requiring that certain information be posted in view of all employees and applicants?
- Are my organization's jobs properly classified as exempt and non-exempt? Would these classifications pass a Department of Labor audit?
- Why does my organization have difficulty attracting and retaining qualified employees?

If so, it may be time for your organization to consider conducting an HR audit.

An HR audit is a comprehensive assessment of the organization's HR function, its structure, systems and procedures, and value delivered to the organization. An audit identifies the relevant effectiveness (or lack thereof) of human resource management practices within an organization as well as measures compliance with ever-changing rules and regulations. A properly executed audit will reveal potential areas of concern and provide recommendations for their remedy.

### Why an HR Audit

It is a common fact that many nonprofit organizations are unable to employ a human resource professional to manage the function. HR is often managed by staff from the finance or administrative teams. More often than not, in nonprofits fortunate enough to have an HR professional, this person may also wear many non-HR hats. Either of the above are scary propositions, given the often cumbersome oversight of federal, state and local government regulatory authorities.

An organization that is unaware of its HR responsibilities is an organization precipitously close to incurring a costly fine or lawsuit. Examples of penalties include:

- DOL fines of \$1,100 for any violation of failing to pay overtime to non-exempt employees;
- OSHA penalties as high as \$10,000 for failing to post required safety notices or keeping accurate records; and
- IRS penalties of \$100 per day per violation and ERISA penalties of \$110 per day per qualified beneficiary for COBRA non-compliance, in addition to damages and court/attorney fees.



These examples point to the significance and importance of compliance. HR compliance means knowing the laws that apply to your organization, developing policies to support the laws and ensuring policy knowledge and consistent application. Above and beyond compliance, effective HR management practices can accelerate organizational development and make a positive impact on organizational financial performance. For example, an audit will review policies and procedures and ensure consistent application across the organization. Fair policies that are applied consistently can lead to improved employee productivity which can positively impact employee satisfaction and retention. With the cost of turnover calculated minimally at 100% of an employee's salary, the value proposition for an HR audit is extremely compelling; it likely will pay for itself many times over.

## HR Audit: 101

### Steps Involved in an HR Audit

HR audits can be – and often are – completed by an internal HR practitioner. However, utilizing an unbiased third party or external consultant to review HR files and interview members of management about HR policies and practices brings added value, objectivity and credibility to the process that an internal HR professional cannot.

Typical audits begin with an extensive document review and data collection process. Examples of discoverable items include personnel and I-9 files, 5500s and plan documents, job descriptions, applicant flow records, hiring/termination checklists and policy manuals. This first step will likely include on-site and off-site reviews. Organizations should make sure that only non-confidential documents without personally identifiable information leave their offices.

Subsequent to the document review should be a series of interviews with HR practitioners and customers including staff, clients and board. These discussions are facilitated with the desired outcome of learning what is needed for organizational compliance and success. The organization should also expect to discuss processes and methods, such as those involved in recruiting and onboarding new employees, emergency preparedness, accident reporting, analyzing exit interview data and managing employee performance evaluations.

The final product of an audit is a diagnosis of which HR practices and policies are efficient and effective and which need improvement, as determined by HR's customers, objectives and industry best practices. The recommendations should be summarized and put into an action plan which serves as a road map for short-term tactical improvements and longer-term strategic changes.

For instance, recently completed audits of several small nonprofit organizations<sup>1</sup> surfaced a number of important findings including:

- The term "applicant" was undefined and candidates for employment were not given the opportunity to self-identify for EEO purposes.
- There was a lack of respect for the HR function, as many established processes were bypassed, eroding the department's credibility and overall potential impact. This led to employees becoming disgruntled as they perceived unfair (even if not illegal) labor practices.

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<sup>1</sup> Findings taken from confidential client audits completed by Nonprofit HR in 2009.



## HR Audit: 101

- Confidential medical information and I-9s were not segregated from the rest of the employee files.
- The HR team did not utilize statistics (i.e. cost per hire, turnover, benefit utilization, exit interview data, etc) and had no objective way to measure their success.
- The manner in which employees' administrative needs were met during their first weeks had a significantly negative impact on their long-term impression of the HR department and organization overall.
- No formal management training program was in place; any training that occurred happened one-on-one in an informal setting. The lack of management training was embodied in the reported lack of appropriate staff feedback, ongoing supervision and often poorly written and delivered staff performance evaluations.

## Components of an HR Audit Report

### Compliance & Recordkeeping

Federal and State Departments of Labor (DOL) dictate mandatory posting requirements for all workplaces. The requirements for posting vary based on several factors, including organization size and physical location.

Organizations deal with a myriad of complex federal and state reporting and compliance issues complicated by frequently new and changing regulations – a perfect example is the ARRA<sup>2</sup> legislation that contained widespread HR implications.

There are many laws which cover the recordkeeping requirements of employee-related documents. Following appropriate recordkeeping and records management protocols allows an organization to operate more efficiently as records are accessible and organized.

### Hiring & Onboarding Practices

Recruiting processes should be designed to attract, hire, and retain a high-performing diverse workforce. By having effective processes in place to support these activities, organizations have a better chance of engaging the most qualified candidates available.

Organizations should have an effective system in place to consistently onboard new employees. Those with comprehensive orientation programs facilitate new employees being productive faster and enjoy better employee retention. The first few days on the job for the new employee will create the initial, and often times permanent, impression of the organization.

### Policies & Procedures

Employee handbooks and procedures manuals are how organizations communicate legally required policies, procedures and protocols to staff. They also establish and support the parameters around which the employment relationship is based as well as ensure consistency in how HR-related matters are handled. The handbook should be updated regularly and reviewed by legal counsel.



## HR Audit: 101

### Compensation & Benefits

An organization with an effective rewards and recognition program will be able to recruit and retain individuals best suited to support the mission of the organization. A total rewards strategy goes beyond basic compensation and fringe benefits and includes creative components that link results with meaningful acknowledgments.

The ability to recruit and retain high performing employees is a compelling reason for an organization to maintain a competitive and comprehensive benefits package. Plan management and administration is critical to ensure that costs are controlled where possible. Regular evaluation of benefit plans and their costs is critical. Organizations also have a fiduciary responsibility under ERISA to ensure that their benefit plans are managed compliantly, and employer mandates exist under the affordable care act for offering health insurance to employees.

Adherence to payroll guidelines and wage payment laws ensures deductions and garnishments are handled properly, pay changes are properly authorized, and employee paychecks are accurate.

### Performance Management & Termination

Effective performance management programs rely on managers to coach and motivate their subordinates. When performance deficiencies arise, they must be managed consistently and fairly throughout the organization. To do this well, an organization needs performance management policies and regular training for supervisors.

Responsible organizations provide employees with a performance feedback system that rewards and recognizes performance expectations, includes a progressive discipline approach that corrects performance deficiencies, and has an equitable termination process that is based on documented behavior and/or performance.

When preparing to terminate an employee, it is essential to follow consistent and compliant organizational procedures in order to eliminate the threat of liability from wrongful discharge and retaliation suits. Understanding the organization's corrective action policies, properly documenting all actions and issues, and effectively communicating to the employee will ensure that this task is handled with fairness, firmness and sensitivity.

## In Conclusion

Most, if not all, nonprofits sacrifice investing in administrative processes in favor of service delivery. While a logical and time-tested approach, the argument can be made that investing in an HR audit significantly reduces both short- and long-term exposure and liability for the organization. Audits do not place a significant burden on staff and usually can be completed in a few weeks. The ROI on an HR audit investment is almost always immediate.

## How Nonprofit HR Can Help

If your organization is interested in conducting an HR Audit or is seeking guidance or consultation concerning other HR matters, please contact Lisa Brown Morton at Nonprofit HR, (202) 785-2060 or via email at [lmorton@nonprofithr.com](mailto:lmorton@nonprofithr.com).



## **HR Audit: 101**

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