

Board of Governors of the Federal Reserve System

**AUDIT OF THE BOARD'S COMPLIANCE
WITH OVERTIME REQUIREMENTS OF
THE FAIR LABOR STANDARDS ACT**



OFFICE OF INSPECTOR GENERAL

March 2007



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

March 9, 2007

The Honorable Kevin M. Warsh
Chairman, Committee on Board Affairs
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Governor Warsh:

In our December 2006 report on the *Audit of the Board's Payroll Process*, we noted a potential issue related to compliance by the Board of Governors of the Federal Reserve System (Board) with requirements of the Fair Labor Standards Act (FLSA). During the conduct of this audit, an officer in the Management Division (MGT) suggested we review the programming logic used by the Board's payroll system to calculate FLSA overtime premiums. To address this issue, we performed additional audit work to determine whether the Board's payroll system correctly calculates FLSA overtime premiums and whether Board employees eligible to receive the premium have been appropriately identified in the system. Because our work focused on the processing accuracy of the Board's payroll system, we did not evaluate specific position descriptions to determine if they were appropriately classified. Our fieldwork, conducted between November 2006 and January 2007, was performed in accordance with generally accepted government auditing standards.

The enclosed briefing package provides our audit findings, conclusions, and recommendations, as well as additional background information and a more in-depth description of our audit objectives, scope, and methodology. We presented these results to responsible MGT and Legal Division officials on March 1, 2007. During the briefing, MGT officials generally concurred with our findings and discussed actions that have been or will be taken to address the recommendations. We will follow up on actions taken as part of future audit and evaluation work.

We appreciate the support and assistance of MGT staff throughout this project. This letter and the enclosed presentation will appear on our publicly-available web page and will be summarized in our semiannual report to the Congress. We are available to answer any questions and we would be happy to brief you or the Committee on Board Affairs on the results of our audit work.

Sincerely,

/signed/

Barry R. Snyder
Inspector General

Enclosure

cc: Vice Chairman Donald L. Kohn
Mr. Stephen R. Malphrus
Ms. H. Fay Peters
Mr. Todd Glissman



Compliance with FLSA Overtime Requirements

O I G

Office of Inspector General

March 2007

Table of Contents

- Background
- Objectives
- Scope and Methodology
- Results
- Recommendations

Background

- The Fair Labor Standards Act of 1938 (FLSA) establishes minimum employment standards, including overtime pay.
 - Employees in positions covered by FLSA are considered ‘nonexempt’ and are entitled to receive compensation for overtime hours worked.
 - FLSA exempts employees in particular positions from the overtime provision, such as those in executive, professional, or certain administrative and computer-related positions.
- Two federal agencies have key FLSA responsibilities:
 - Department of Labor (DOL) establishes regulations and guidance governing private sector employers.
 - Office of Personnel Management (OPM) establishes regulations and guidance applicable to the federal government.

Background

- Both sets of regulations provide guidance for calculating overtime, to include what the Board refers to as the “FLSA premium.”
 - The calculation factors in other forms of premium pay, such as night differential or Sunday pay.
 - The FLSA premium results in compensation that exceeds the traditional time and one-half for overtime hours worked.

Background

- DOL and OPM regulations differ in their computation of the FLSA premium. For example:

Provision	DOL Regulation	OPM Regulation
Hours worked – Daily overtime	Overtime must be paid for hours worked in excess of 40 hours in a workweek.	Allows overtime to be paid for hours worked in excess of 8 hours in a day or 40 hours in a workweek. ¹
Hours worked – Leave	Hours spent in a paid leave status (i.e., sick or annual leave) are not included in overtime calculations.	Hours spent in a paid leave status (sick or annual leave) are included in overtime calculations.

¹ The OPM regulation accommodates flexible work schedules in determining what qualifies for overtime on a daily basis (i.e., 9-hour or 10-hour workdays)

Background

- The Board of Governors of the Federal Reserve System (Board) has independent pay and compensation authority under Section 10 of the Federal Reserve Act.
 - When FLSA amendments made the law applicable to federal employees in 1974, the Board approved voluntary compliance with FLSA to provide equitable payment of overtime and directed that adequate procedures be established to ensure Board policies reflect the purpose of the law.
- The Board's policy on *Premium Pay for Overtime and Holidays* states that overtime for nonexempt employees will be paid using FLSA guidelines. The policy also authorizes paying overtime to all wage grade employees, which the policy defines as employees paid based upon "an hourly rate schedule in a recognized craft or labor position."

Background

- The Board maintains a customized version of an off-the-shelf software application to manage its payroll and other human resources information.
 - The Management Division (MGT) has overall responsibility for payroll processing.
 - MGT's Administrative Systems Automation Program (ASAP) provides technical, infrastructure, and administrative support for the software application.
 - ASAP staff developed a software program to compute the FLSA premium; the program must be manually initiated each payroll cycle.

Objectives

As we noted in our December 2006 report on the *Audit of the Board's Payroll Process*, we identified a potential issue related to compliance with FLSA requirements. This issue was initially brought to our attention by an officer in MGT. We deferred additional FLSA-related audit work until the payroll audit report was finalized.

Our audit objectives were to:

- Determine whether the Board's payroll system correctly calculates FLSA premiums
- Determine whether Board employees eligible to receive the FLSA premium under the law and accompanying regulations have been appropriately identified in the system

Our objectives focused on the Board's payroll system and the accuracy of system processing. Accordingly, we did not evaluate specific position descriptions to determine if they were appropriately classified.

Scope and Methodology

- Interviewed MGT and Legal Division staff
- Reviewed Board policies and legal documents
- Reviewed FLSA provisions and corresponding regulations from DOL and OPM
- Interviewed DOL and OPM staffs
- Evaluated payroll data, and recalculated FLSA premiums, for the first half of 2006
- Conducted the audit in accordance with generally accepted government auditing standards

Objective 1: Results

We found that the software calculation for the FLSA premium is correct, however there were instances where these payments were not processed.

- ASAP staff developed a software program to compute the FLSA premium. Our recalculation of 955 FLSA premium payments made during the first half of 2006 generally confirmed the computation's accuracy, with expected variances due to rounding.
 - We identified 5 differences greater than five cents which we provided to MGT staff for their detailed review. These discrepancies may be related to timing differences.

Objective 1: Results

- Payroll staff must manually initiate the process to compute the FLSA premium. We found that:
 - The process was not executed for one pay period in May 2006, therefore, no FLSA premiums were paid for that pay period.
 - For several other pay periods in 2006, a few employees did not receive the FLSA premium possibly because all other forms of premium pay that affect the FLSA premium calculation had not been entered before the FLSA premium process was executed.
 - The missed payments totaled approximately \$660 and affected 85 employees.
 - We confirmed the missed payments for May 2006, totaling almost \$560, were corrected.
 - Payroll staff informed us the remaining missed payments have also been corrected.
 - Payroll staff also requested that ASAP automate the process to run the FLSA premium calculation.

Objective 1: Results

- The customized software does not properly process negative FLSA premiums resulting from adjusting entries.
 - Adjusting entries may result from reversal/correction of another type of premium pay.
 - The customized software does not post a corresponding negative adjustment to the employee's FLSA premium.

Objective 2: Results

Our analysis showed that nonexempt staff who receive the FLSA premium, in accordance with current Board practice, are properly identified in the payroll system.

The table below identifies categories of Board employees and corresponding premium pay information.

	Exempt	Non-exempt		Wage Grade	
Grade	FR21-29	FR31-36	FR21-24	41-46	45-47
Pay Group ¹	FR2	FR1	FR2	ENG & WE	WE
System FLSA status	Exempt	Nonexempt	Nonexempt	Nonexempt	Exempt
Received Overtime?	Yes ²	Yes	Yes	Yes	Yes
Received Other Premium Pay?	Yes ² (ND, Sun, Hol)	Yes (ND, Sun, Hol)	No	Yes (Shift, Sun, Hol, OT2/3, SU2/3, HL2/3)	No
Received FLSA premium?	No	Yes	No	No	No

Highlighted cells indicate discussion points on subsequent slides

¹ Pay Group is a payroll system identifier

² A limited number of exempt employees receive these payments

Premium Pay Key

ND = Night differential Sun = Sunday

Hol = Holiday

OT2/3 = 2nd or 3rd shift overtime in addition to standard overtime & shift

SU2/3, HL2/3 = Sunday or Holiday shift pay in addition to shift

Objective 2: Results

As the data in the previous table shows, not all nonexempt employees receive the FLSA premium. Although overtime payments generally meet or exceed FLSA requirements, the Board's current premium pay policy does not adequately describe the different methods used to calculate overtime.

We identified several differences between Board policy and practice as described on the following slides.

Objective 2: Results

- Board policy:
 - Overtime for nonexempt employees will be paid using FLSA guidelines if no leave is taken during the basic workweek.

- Board practice:
 - The FLSA premium calculation uses the appropriate formula in accordance with FLSA guidelines. However, staff in positions recently reclassified as nonexempt do not receive other types of premium pay, such as night differential or Sunday pay, which would generate an FLSA premium payment.
 - These positions remain assigned within the payroll system to a pay category associated with exempt positions, even though their FLSA status is nonexempt.
 - If the Board were to decide to pay these employees other types of premium pay, the payroll system, as currently configured, would not pay these employees the FLSA premium.
 - Leave is not a factor in the Board's overtime calculation.

Objective 2: Results

- Board policy
 - Overtime for all wage-grade employees will be paid at one and one-half times the basic hourly rate of pay.
- Board practice
 - Overtime calculation includes more than the basic hourly rate of pay for wage grade positions earning shift differential.
 - These nonexempt employees receive a form of overtime compensation that factors the shift differential into supplemental overtime pay.

Objective 2: Results

- Board practice (continued)
 - Because their overtime pay generally exceeds the FLSA premium, staff in wage grade positions are not paid the FLSA premium.
 - In the first half of 2006, these employees received approximately \$1,870 more in overtime compensation than they would have received with the FLSA premium.
 - However, we identified nine shift employees who did not receive the FLSA premium or the higher supplemental overtime pay for all overtime hours worked. These employees may have been underpaid by approximately \$145.

Recommendations

- **We recommend that the Director of MGT enhance FLSA premium processing by**
 - **establishing controls to ensure all other forms of premium pay are entered before the process is run,**
 - **establishing controls to ensure the process is run or eliminating the manual intervention required to initiate the process, and**
 - **correcting the system logic for processing FLSA premium adjustments.**

Recommendations

- 2. Consistent with a recommendation in our report on the *Audit of the Board's Payroll Process*, we recommend that the Director of MGT revise the current policy for premium pay to
 - a) accurately describe the methods of calculating overtime pay for all Board employees, and**
 - b) ensure the policy fully reflects the purpose of the FLSA.****

This revision may require system modifications to appropriately implement the new policy.