Conducting a Pay Equity Audit

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This Practice Note provides practical guidance for employers considering performing a pay equity audit to assess pay disparities among employees performing equal or substantially similar work. This Note addresses the potential benefits and drawbacks of pay equity audits, the purpose and parameters of the audit, privilege considerations, practical guidance for conducting the audit, and post-audit considerations and remediation strategies. This Note is jurisdiction-neutral.

Women are entitled to equal pay under federal and many state laws and have been for decades. Despite the existing legal protections, there remains a significant pay gap between men and women. The commonly cited 80% pay ratio means that women earn approximately 80 cents for every dollar earned by men (and even less for women of color), resulting in about a 20% wage gap (Institute for Women's Policy Research: The Gender Wage Gap 2018). While some have reported that the disparities are decreasing, the pace of progress is slow (Pew Research Center: The Narrowing, But Persistent, Gender Gap in Pay).

Employers are subject to increasing legislative, political, and public pressure to remedy the gender pay gap and achieve pay equity. The momentum has been fueled in part by the #MeToo and Time's Up movements' heightened attention to the treatment of women in the workplace. This in turn has spawned a wave of recently enacted and proposed pay equity legislation and increased enforcement of existing pay equity legislation, including through class action litigation. Some of these laws include safe harbors for employers that take affirmative steps to eliminate or reduce pay disparities.

The first step for many employers when addressing a potential pay disparity is to conduct a pay equity audit. An audit can help employers determine whether:

- Any pay disparities exist.
- The pay disparities are limited to a specific portion or portions of the employee population, for example, a single workplace, department, or pay band.
- The disparities can be explained by legitimate business justifications other than sex (or another protected class characteristic).

This Note provides practical guidance to employers considering conducting a pay equity audit, including:

- The potential benefits and drawbacks of pay equity audits.
- Determining the purpose and parameters of the audit.
- Privilege considerations.
- Practical considerations when conducting the audit, such as:
  - identifying the key participants in the audit;
  - data assessment and collection;
  - privacy and data security issues; and
  - options for conducting statistical analyses.
- Post-audit considerations and remediation strategies.

While this Note focuses on gender equity, the principles apply equally to audits seeking to identify and remedy pay disparities between any employee groups based on other protected class characteristics, such as race or nationality.

For more on sex discrimination under federal and state law, see:

- Practice Note, Sex Discrimination Under Title VII and the EPA (9-601-1465).
- Anti-Discrimination Laws: State Q&A Tool.

For more on wage and hour liability generally, see:

- Practice Note, Wage and Hour Law: Overview (2-506-0530).
- Wage and Hour Laws: State Q&A Tool.
- Wage and Hour Claims Toolkit (7-500-3815).

LEGAL FRAMEWORK OF EQUAL PAY LAWS

Numerous federal, state, and local laws prohibit discrimination based on sex, including discrimination in pay and benefits.

FEDERAL LAWS

Federal law guarantees women equal pay for equal work under:

- Title VII of the Civil Rights Act of 1964 (Title VII).
- The Equal Pay Act (EPA).
- The Lilly Ledbetter Fair Pay Act (see Lilly Ledbetter Fair Pay Act of 2009).

Title VII prohibits workplace discrimination on the basis of sex, among other protected class characteristics. Prohibited conduct includes sex discrimination in an individual's compensation, terms, conditions, or privileges of employment. (42 U.S.C. § 2000e-2(a)(1)).

The EPA prohibits sex-based discrimination in payment of wages for equal work (29 U.S.C. § 206(d)). The EPA amended the Fair Labor Standards Act (FLSA) and follows FLSA law on several points, such as the statute of limitations and available remedies.

The EPA requires that employers pay male and female employees equal wages for equal work on jobs that require equal skill, effort, and responsibility to perform, and are performed under similar working conditions in the same establishment. Under the EPA, the term "wages" is extremely broad and includes all forms of compensation or payments made to or on behalf of an employee as compensation for employment, including:

- Wages or salaries.
- Deferred compensation, including profit sharing plans.
- Expense accounts, gasoline allowances, uniform cleaning allowances, and similar payments and benefits.
- Use of a company car.
- Bonuses.
- Vacation and holiday pay.
- Premium pay for working on weekends or holidays.
- Any fringe benefits, such as medical, hospital, accident, life insurance, and retirement benefits.

(29 C.F.R. §§ 1620.10 to 1620.11.)

Employers can defend against an EPA claim when any unequal wages result from:

- A seniority system.
- A merit system.
- A system that measures earnings by quantity or quality of production.
- Any factor other than sex if the employer does not reduce the wage of any employee to comply with the EPA.

(29 U.S.C. § 206(d)(1)(i) to (iv).)

Employers defending sex-based pay discrimination claims under Title VII may also take advantage of the affirmative defenses available under the EPA (42 U.S.C. § 2000e-2(h); see Practice Note, Sex Discrimination Under Title VII and the EPA: Defenses Under the EPA (9-601-1465)).

Lilly Ledbetter Fair Pay Act of 2009

The Lilly Ledbetter Fair Pay Act amended Title VII and other federal statutes in response to the Supreme Court's decision in *Ledbetter v. Goodyear Tire & Rubber Co.* (550 U.S. 618 (2007)). In *Ledbetter*, a divided Supreme Court barred the plaintiff's claims based on pay decisions made more than 180 days before her EEOC charge filing (see Practice Note, Exhaustion of Administrative Remedies and Statutes of Limitations Under Employment Discrimination Laws (9-521-7561)). Under the Lilly Ledbetter Fair Pay Act, when determining the timeliness of an unfair pay claim, an unlawful employment practice relating to discrimination in compensation occurs when any of the following happens:

- An employer adopts a discriminatory compensation decision or other practice.
- An individual becomes subject to a discriminatory compensation decision or other practice.
- An individual is affected by the application of a discriminatory compensation decision or other practice, including each time wages, benefits, or other compensation are paid.

(42 U.S.C. §§ 2000e-5(e)(3), 2000e-16(f), and 12117(a); 29 U.S.C. §§ 626(d) and 794a(a)(1).)

Therefore, each time an employee receives a paycheck that stems from a discriminatory pay practice or policy, a new limitations period begins to run.

STATE AND LOCAL PAY EQUITY LAWS

Beyond the federal pay equity protections, many state and local jurisdictions have prioritized pay equity and related issues. Some state laws, such as California's, provide broader pay protections and also prohibit pay disparity based on race or ethnicity (see Practice Note, Discrimination Under the California Equal Pay and Fair Pay Acts (W-019-1008)). New York provides broader protections by requiring employers to provide equal pay for equal work within the same geographical region, not only within the same establishment (N.Y. Lab. Law § 194(3)).

At the state and local level, lawmakers have passed various wage-gap initiatives like salary history bans. Salary history bans, also referred to as pay or wage history bans or wage-gap laws, generally prohibit employers from inquiring about an applicant's prior wages or benefits during the pre-employment process or considering that information when making recruiting, hiring, or compensation decisions. The goal is ensuring that compensation is based on job-relevant criteria, such as applicant qualifications, job duties and responsibilities, and market factors. Proponents of salary history bans argue that using past compensation in future employment decisions perpetuates existing pay disparities among women and minorities. Salary history bans (and exemptions from those bans) vary widely among state and local jurisdictions. Some laws have been passed as stand-alone initiatives while others have been enacted as part of broader pay equity or pay transparency legislation. Employers conducting pay equity audits must not rely on employees' pay history to justify pay disparities in those jurisdictions that prohibit this practice.

For more on salary history bans, see Practice Note, State and Local Salary History Bans (W-005-9410) and State and Local Salary History Laws Chart: Overview (W-011-0681).

POTENTIAL BENEFITS AND DRAWBACKS OF CONDUCTING PAY EQUITY AUDITS

Conducting a proactive, self-driven pay equity audit can be a time-consuming and resource-intensive process. However, employers may find that a properly executed audit provides potential benefits that outweigh potential drawbacks, such as reducing the risk of costly pay discrimination litigation. Companies may also face serious reputational damage and decreased business performance when dealing with pay disparity allegations and lawsuits.

BENEFITS OF PAY EQUITY AUDITS

Employers can reap many benefits from conducting a pay audit, including:

- **Avoiding or defending against costly litigation**. Conducting a pay audit may allow employers to:
  - demonstrate that there are no legally actionable pay disparities;
  - provide legitimate explanations for apparent or perceived disparities; or
  - promptly and effectively remedy disparities if they are discovered.
- **Gaining safe harbor protection under applicable pay equity laws**. In some jurisdictions, such as Massachusetts and Oregon, employers may have an affirmative defense to pay discrimination claims (a "safe harbor") if they:
  - conduct a good faith, reasonable pay audit before any lawsuit is filed; and
  - make reasonable progress in eliminating any prohibited gender-based wage disparities discovered by the audit.
- **Publicly demonstrating a commitment to pay equity**. By showing their affirmative commitment to pay equity using proactive audits and pay adjustments, companies may improve their business reputation, which may lead to increased investment and improved performance.
- **Improving employee recruitment and retention**. Evidence or even rumors of pay disparities can severely hinder a company's ability to recruit and retain a diverse workforce. Employees may lose trust and confidence in their leadership's commitment to maintain and fairly compensate a diverse workforce. A pay equity audit, combined with appropriate remediation of any indefensible pay gaps or a commitment to resolving systemic problems, can mitigate these concerns. Employees who feel that their value to a company is aligned with the company's compensation philosophy likely are more engaged in their work, which can lead to increased employee retention.
- **Responding to increasing shareholder activism**. Many public companies face stricter corporate governance requirements amid a changing social landscape and increasing shareholder activism where management is expected and often required to proactively identify and remedy pay disparities beyond strict legal requirements. The rise in shareholder proposals directing a company's leadership to investigate, identify, and remedy pay disparities can have a significant impact on the company's financial and human resources.

POTENTIAL DRAWBACKS AND RISKS

Pay equity audits are not without their risks, including:

- **Disclosure of unfavorable audit results**. The unintended disclosure of audit results is a primary risk and can occur when an audit's results or processes are not privileged or not handled in a confidential manner and are discoverable in litigation. This can result from the careless treatment of otherwise privileged or confidential information, including discussion of the audit with individuals outside of the audit team or even inadvertent placement of a confidential document in a public location. When an audit reveals significant pay disparities, its intended or unintended disclosure provides potential plaintiffs, their counsel, and administrative agencies with critical evidence to support alleged pay discrimination claims. Companies undertaking a pay equity audit therefore should make every effort to establish and preserve the attorney-client privilege and work product protections that can help prevent disclosure of sensitive compensation information.
- **Providing evidence of known violations**. Worse than not conducting an audit is conducting an audit that reveals unjustifiable pay disparities and then doing nothing to remedy the problem. An employer's inaction may provide direct evidence of a knowing and willing violation which may subject the employer to higher penalties or liquidated damages in any ensuing litigation. If an employer is not committed to conducting remediation (at least to some extent) of any discovered disparities that are not explained by legitimate factors other than sex (or other protected characteristic, such as race or ethnicity in California), then an audit may be more harmful than helpful.
- **Employee suspicion of results**. Even if an audit reveals no statistically significant pay disparities, the employer may choose to disclose the results to its workforce. Some employees may be suspicious of positive audit results. This may lead employees to file suit or threaten litigation to force the company to disclose the underlying information in discovery, including the data collected or the audit methodologies and processes used. Companies can minimize the risk of this disclosure by closely protecting the confidentiality of these audits (see Legal Counsel and Privilege and Communication Strategies). Even if employees do not file suit or threaten litigation, employee suspicion by itself can contribute to decreased employee morale, leading to increased attrition and poor work performance.

ESTABLISHING THE PURPOSE AND PARAMETERS OF THE PAY EQUITY AUDIT

To best ensure a productive pay equity audit, employers should clearly identify:

- The purpose and goals of the audit.
- The desired breadth and scope of the audit, including:
  - the business unit or units covered;
  - the time period analyzed;
  - the physical locations covered;
  - the forms of compensation to be analyzed; and

- the data points analyzed, such as an employee's location, gender, age, race, ethnicity, education, experience, performance, production metrics, and other factors that may correlate with, or even explain, pay disparities.

DETERMINE THE PURPOSE AND GOALS OF THE AUDIT

The legal and business considerations that determine whether to conduct a pay equity audit help establish the audit's purpose. If a company is facing immediate or threatened pay discrimination litigation, the company's audit may be driven by timing considerations, limiting liability, and minimizing public backlash. A company facing immediate or threatened litigation generally can rely on both the attorney work product doctrine and the attorney-client privilege to protect the confidentiality of the audit.

However, a company conducting a pay audit for general compliance purposes may not be entitled to the same protections, as it is likely driven by other factors, such as achieving a compensation structure that mirrors the company's cultural goals and avoiding costly litigation in the future. Although this type of proactive, self-driven pay equity audit is encouraged, it requires careful consideration of processes and team selection to maintain confidentiality and privilege. A pay equity audit for compliance purposes may be covered by the attorney-client privilege, but is not covered by the work product doctrine. A pay equity audit conducted for non-legal purposes, such as for recruiting or reputational benefits, is not covered by the work product doctrine or attorney-client privilege.

A company's immediate realities and long-term goals influence its underlying purpose for performing a pay equity audit. From the outset, a company must determine whether its goals are:

- Identifying pay disparities.
- Remedying pay disparities.
- Identifying and changing the systems or processes potentially causing these disparities.

These goals are not mutually exclusive and can be pursued in a complementary fashion over a period of time, depending on the company's resources. It is important to recognize that each goal may be most effectively addressed by a different type of audit because of timing and cost considerations. The types and quantity of resources that each type of audit requires, whether financial or effort-based, may vary. For example, an audit done in response to litigation may reveal that the company's liability exposure is lower than expected or nonexistent, so the company may wish to pursue a foundational approach instead of expending more resources as typically required under a remedial approach (see Different Approaches to a Pay Audit). Ideally, a company should consider which goal or goals are most appropriate at any given time and be prepared to reevaluate the company's needs in the future.

Different Approaches to a Pay Audit

Depending on its goals, a company can choose one or more approaches to a pay audit, such as a:

- Foundational audit.
- Remedial audit.
- Causal analysis (or root causes) audit.

The goal of a foundational audit is to identify any potential pay disparities and perhaps isolate the issue to specific departments or groups. The focus is on data collection and analysis to determine if any statistically significant pay disparities exist. This may be the most effective approach when a company has an objective, well-documented, and fair compensation approach, but still faces immediate or threatened litigation and must quickly investigate to determine whether it faces substantial liability exposure. This audit approach is also typically used when a company lacks the financial resources to remediate any identified disparities, at least in the short term.

With a remedial audit, a company takes the additional step of creating a remediation plan to address any identified pay disparities. A company should develop a detailed remediation plan to properly plan for unexpected results and maintain fiscal responsibility (see Develop a Thorough Remediation Plan).

Using a causal analysis approach, a company looks beyond the data and analyzes whether and to what extent its own internal systems and processes may be causing or contributing to pay disparities. This includes an analysis of:

- Compensation and incentive philosophy, policies, practices, and procedures.
- Methods of talent acquisition, talent retention, and promotion.
- Whether the company is relying on fair and job-related performance review metrics and methodologies.

A causal analysis may ultimately require structural changes to a company's management and operations.

ESTABLISH THE BREADTH AND SCOPE OF THE AUDIT

Geographical and organizational considerations are usually the primary factors in determining the breadth of an audit. For companies with a geographically concentrated and relatively small workforce, the breadth of an audit may encompass the entire workforce. However, for larger, more geographically dispersed or diversified companies, they should consider whether an audit will be company-wide or target specific units, departments, or locations.

If a large and complex company is conducting a pay equity audit for the first time, collecting and analyzing the raw data for the entire company may pose a significant undertaking from a logistical and financial perspective. These companies may consider first conducting a pay equity audit for a smaller subset of employees. This can allow companies to assess how best to broaden the audit scope depending on information obtained during the audit and to establish more robust protocols and processes for a future company-wide audit.

For multi-state and multinational companies, an audit's scope may be driven primarily by geographic considerations, especially because different jurisdictions may have different compliance requirements. For example, Massachusetts has an equal pay statute that only applies to gender-based pay discrimination (M.G.L. ch. 149, §§ 105A to 105C). New York has passed legislation expanding coverage of its equal pay statute to additional protected characteristics (N.Y. Lab. Law § 194) (effective October 8, 2019)). California and New Jersey's equal pay statutes apply to additional protected characteristics, such as race and ethnicity (Cal. Lab. Code § 1197.5; N.J.S.A. 10:5-12(t)). Illinois' equal pay statute applies to gender and limits race-based protections to African-Americans only (820 ILCS 112/10). Defining the jurisdictional breadth helps a company set the scope of the audit for whatever protected characteristics will be the audit's focus (for example, sex, race, ethnicity, and national origin).

DEVELOP A THOROUGH REMEDIATION PLAN

Companies with a remediation goal should develop a thorough plan that accounts for resource constraints, anticipated employee reactions, and timing considerations.

Resource Constraints, Employee Reactions, and Strategic Considerations

Companies must consider the financial resources available to remedy any identified pay disparities. It is helpful to establish a general remediation approach before seeing the results of a pay equity audit. A plan that is reactive to unexpected results can:

- Limit the opportunity to realize long-term pay equity benefits. For example, a company may plan to remediate across the company based on certain criteria, but if the results of the audit are unexpected, the company may rely on discretionary judgments to develop a new remediation plan. Deviating from the identified plan increases the risk that bias may influence the remediation plan, potentially perpetuating disparities.
- Expose the integrity of the audit process and results to criticism that the audit was skewed or biased to achieve a certain outcome.

Determining which employee groups (such as men versus women or non-minorities versus minorities) will benefit from a remediation plan may impact employee morale. For example, a pay equity audit may reveal pay disparities among a broad group of workers, whether by work unit or geography. Even a company that sets aside funds to remediate may realize that pay disparities exceed available remediation funds. A company with limited financial resources should be prepared to make difficult decisions about prioritizing which employees will receive remedial pay adjustments and over what time period. To help guide this difficult decision-making process, companies should establish guidelines stating, for example, that compensation decision-makers should:

- Not reduce or freeze employee compensation to eliminate disparities.
- Rely on consistent percentage increases for remediating the selected group, rather than allocating remediation amounts based on discretion.
- Prioritize remediating comparator job groups (based on equal or substantially similar work), job positions or titles, or geographical areas where the disparities are largest.

Prioritizing specific employee groups for remediation requires careful thought to ensure short-term remediation plans are consistent with and support long-term pay equity goals. For example, after determining which comparator job groups or geographic areas will be prioritized, a pay equity analysis may reveal that both men and women in a particular comparator job group appear to be underpaid. Remediating underpaid employees of both genders may sound fair, but it can worsen the pay gap because pay increases for men may counter the adjustments made for women and prevent the reduction or elimination of a pay gap. Companies should therefore consider designating one employee group as the predominantly disadvantaged group that will receive remediation.

To minimize the risk that remediation of only one employee group will lead to complaints by the non-remediated employee group, companies should implement the pay adjustments to coincide with periodic pay adjustment cycles. Companies should also commit to performing another pay equity analysis in the near future to determine if there are still pay disparities among other employee groups, and if so, whether those employee groups should be the focus of any subsequent remediation plan. A commitment to remediating pay disparities that impact the identified disadvantaged employee group is crucial, especially if the results do not align with expectations. Companies should consult with experienced counsel when implementing a remediation approach to minimize the risk of discrimination liability.

Timing of Audit

Whether a company plans on implementing a one-time or long-term remediation plan, it should consider timing the completion of its pay equity audit to coincide with its annual review, promotion, or pay increase cycle. Off-cycle pay adjustments can increase litigation risks and foster poor employee morale because it may lead to speculation that the company does not pay fairly or equitably or suggest that the company likely has violated pay equity or other anti-discrimination laws. Employees may be suspicious of the reasons offered for these off-cycle adjustments, leading to gossip or speculation about which employees received remediation.

IDENTIFYING KEY PARTICIPANTS IN CONDUCTING A PAY EQUITY AUDIT

A properly designed pay audit requires a substantial effort and commitment by multiple levels of a company's workforce, ranging from executive leadership and human resources to local management. Careful planning regarding audit communications among these groups is crucial to maintaining the desired confidentiality and realizing the long-term benefits of a pay equity audit.

COMPANY LEADERSHIP

It is vital that company leadership at its highest levels supports and is committed to a pay equity audit. A company's leadership team generally:

- Has the power to ensure that company values align with employee compensation.
- Helps set cultural and reputational goals.
- Is critical to authorizing any remediation efforts.

The leadership team must also understand and agree on the amount of time and money the company is willing to spend on an audit so that it can appropriately define the breadth and scope of the audit and budget for later remediation.

HUMAN RESOURCES AND PAYROLL

Human resources and payroll personnel are typically essential to compiling the necessary employee data stored on payroll, timekeeping, performance management databases, and other human resources information systems for a well-constructed audit (see Data Security, Collection, and Analysis Considerations). While the core human resources audit team generally remains involved throughout the audit, the involvement of other audit participants is usually limited to the information gathering and delivery stage to protect the audit's confidentiality (see Privilege and Communication Strategies).

Large companies with a robust human resources department may be able to quickly deliver complete and polished data. However, smaller companies likely must work closely with the audit team to ensure that sufficient and accurate information is available.

Similarly, companies that engage a professional employer organization (PEO) to provide payroll processing, employee benefits administration, human resources support, and other services, must coordinate with their PEO to obtain complete and accurate data. Companies that rely on a PEO for these services generally can protect communications with PEO personnel under the attorney-client privilege because a PEO not only is an agent of the company, but also may be necessary, or at least highly relevant, to the pay audit. Companies that rely on both in-house and PEO personnel to provide compensation information, however, must carefully review the scope of the PEO's services and determine whether a PEO is a necessary member of the audit team. For a sample PEO agreement, see Standard Document, PEO Client Service Agreement (2-529-7405).

Company personnel are typically expected to review the raw data to ensure its completeness and accuracy. Companies that have recently transitioned from hard-copy to digital document storage methods, or from simple spreadsheets to professional recordkeeping platforms, should also review the raw data during the transition period. Even if a company has not undergone a recent transition in payroll or compensation protocols, human resources and payroll personnel should conduct an early review and correct any data errors, ranging from simple typos to incorrect employee classifications, to avoid inaccurate pay equity results.

LEGAL COUNSEL

If a company has in-house legal counsel, their involvement is crucial to protecting an audit's confidentiality (see Privilege Considerations). If a company does not have in-house counsel, a designated chief compliance officer generally assumes responsibility for protecting an audit's confidentiality by assuming tasks, such as retaining outside counsel. Either in-house counsel or the chief compliance officer should consistently and properly document the company's process in setting the audit's scope and purpose which helps protect against later attempts to attack the audit's privileged nature or the methodologies used in the audit.

In addition, in-house or outside legal counsel should directly engage any third parties whose services are necessary for the pay audit, such as statisticians or labor economists. Allowing legal counsel to lead this effort helps underscore that the services of a third party are necessary to allow counsel to deliver legal advice. Otherwise, a court may find that the third party was engaged in the ordinary course of business, rather than for the purpose of obtaining legal advice.

PRIVILEGE AND COMMUNICATION STRATEGIES

PRIVILEGE CONSIDERATIONS

It is difficult for most companies to accurately predict the results of a pay equity audit. From a risk-management perspective, employers typically desire to maintain the confidentiality of an audit's data, analytic processes, and results. The attorney-client privilege and the work product doctrine may both offer varying degrees of protection. Attorney work product protections only apply to materials prepared in anticipation of existing or threatened litigation, while the attorney-client privilege more generally applies to confidential communications for the purpose of obtaining or rendering legal advice. Failure to establish and maintain either protection exposes communications or work product, such as audit processes and results, to potential discovery in litigation. This information can provide potential plaintiffs or government agencies with fodder for an investigation or lawsuit.

Companies must adhere to strict protocols to establish and preserve the attorney-client privilege. When preparing for a pay audit, they should:

- Determine whether outside counsel is necessary. Courts may view in-house counsel as primarily or purely functioning in a business capacity, which can create ambiguity about whether communications have a legal purpose. Engaging outside counsel for their legal expertise clearly establishes the legal purpose of the audit, but this should be explicit in any engagement letter.
- Set the scope, breadth, and approach of the pay equity audit depending on the purpose of the audit, in particular, whether the audit is:
  - in response to pending or threatened pay discrimination litigation; or
  - part of a proactive legal compliance exercise.
- Identify and limit the pay audit team members to those who are relevant and necessary. Even for team members, such as legal counsel, companies must ensure that their role involves legal compliance by providing legal analyses, conclusions, and recommendations.
- Allow counsel to engage any necessary third parties, such as experts or consultants. Counsel should also ensure that any third parties sign nondisclosure agreements.
- Establish protocols, such as the preferred methods and manner of communications and the distribution and preservation of privileged and other confidential materials.
- Communicate to the audit team that the attorney-client privilege only applies to communications that are:
  - meant to be confidential; and
  - made for the purpose of obtaining or rendering legal advice.

For more on the attorney-client privilege and work product doctrine, see Attorney-Client Privilege and Work Product Doctrine Toolkit (0-501-1475).

COMMUNICATIONS TO COMPANY MANAGEMENT

Because an audit's confidentiality is best protected by limiting its participants to necessary personnel, neither company leadership nor human resources and payroll personnel are likely to be involved in the analysis phase with legal counsel and experts. Once the audit results are available, a company faces strategic considerations about how much to disclose and to whom.

Companies should consider communicating only structural and policy changes to line management, while maintaining the confidentiality of individual compensation remediation decisions. Releasing audit results to line management may result in a waiver of the attorney-client privilege, especially where line management personnel lack a clear "need to know." However, failing to adequately inform line management about audit results may hinder management's ability to identify factors contributing to pay disparities. This can be exacerbated in areas where line managers exercise broad discretion, such as employee recruitment, retention, and promotion decisions.

To balance these competing interests, a company should develop a remediation approach that accomplishes its short and long-term pay equity goals without significant day-to-day involvement from line management. For example, implementing a carefully designed pay band structure or compensation matrix should minimize the need for line management to exercise discretion in setting compensation, therefore minimizing the need to inform them of the pay audit's specific results.

Companies should also cautiously consider whether to disclose pay audit results to executive-level decision-makers, shareholders, or investors. On the one hand, it is enticing to publicize a pay audit that revealed minimal to no unjustified discrepancies or to publicize a proactive compensation remediation plan. These favorable disclosures may lead to increased investment, valuation, or other competitive benefits. On the other hand, disclosing an audit's processes and results risks waiving any confidentiality or privilege protections. While companies may attempt to limit any waivers to a specific subject matter area, there is a material risk that a court may find a blanket privilege waiver of other related subject matters.

COMMUNICATIONS TO EMPLOYEES

Communications to employees about an audit's underlying data and results pose an even greater risk of waiving the attorney-client privilege. Even if a pay equity audit reveals positive results that show the company is achieving pay equity or doing so at a level that is better than expected, companies should carefully consider the litigation risks of disclosure. Employees or their counsel may attack the audit's processes or methodologies to argue that the results are skewed and inaccurate.

DATA SECURITY, COLLECTION, AND ANALYSIS CONSIDERATIONS

A pay equity analysis usually includes the following steps:

- Consideration of data privacy and security laws.
- Collecting extensive data, including at least:
  - compensation information;
  - employee personal information; and
  - workforce data, including data on factors that a company uses to set or determine pay.
- Determining comparator job groups comprised of positions where employees perform equal or substantially similar work.
- Conducting a regression analysis for each comparator job group, where possible, to assess if pay disparities exist between employees of the opposite sex, another race, or another ethnicity, depending on the scope of the audit.
- Reviewing discrepancies at an aggregate level, adding legitimate job-related factors to explain wage disparities for reasons other than a protected class characteristic.
- Reviewing discrepancies at an individual level to ensure the relevant employment data was completely and accurately captured.

PRIVACY AND DATA SECURITY ISSUES

The collection and use of employee information to conduct a pay equity audit raises potential privacy concerns. To prevent unauthorized disclosure and inspire confidence that the pay equity audit process and results remain confidential, a company should engage data privacy experts as part of the audit team to ensure data privacy and security of underlying data. For information on privacy and data security laws in the US, see Practice Note, US Privacy and Data Security Law: Overview (6-501-4555).

For pay equity audits involving employees located in any member state of the European Union (EU), companies must comply with the General Data Protection Regulation (GDPR). The GDPR mandates minimum standards for companies that handle EU citizens' personal data. These standards include employee consent for data collection and processing, anonymized data, and data breach notifications. For information on complying with the GDPR, see Practice Note, Demonstrating Compliance with the GDPR (W-005-2644). Many other countries similarly require informed consent before using any employee data, certain security protocols for cross-border data transfers, or heightened protections depending on the type of employer and industry.

EMPLOYEE PERSONAL INFORMATION

The scope of a pay equity audit, including the protected characteristics (such as gender, race, or ethnicity) that are the focus of the audit, influences what employee personal information must be collected. Any audit, however, requires the collection of certain baseline information, such as employee name or identification number, and age. Whether a company collects information about gender, race, or ethnicity depends on the audit's scope.

WORKFORCE DATA

One of the most important data sets used in a pay equity audit is workforce data, including job titles and classifications and other employment-related information. How a company classifies jobs and their accompanying job duties and responsibilities is important for both short-term pay equity auditing and long-term operations purposes. Large companies face the greatest risk of inconsistent application of job titles because of a dispersed workforce. Local management may make ad hoc classification decisions that do not comply with company policies or fail to correspond with an employee's actual job duties and responsibilities. Job titles are often a core driver of compensation, so companies must ensure that job titles are consistently and accurately applied.

In preparing for a pay equity audit, companies should work closely with local management, human resources, and payroll personnel to ensure that the job information collected is accurate and reflects their employees' actual skill, effort, and job responsibilities. If a company identifies inaccurate, incorrect, or missing information, company personnel should correct or obtain the information as quickly as possible.

In addition to employees' job classifications, companies should also collect information on their employees':

- Full-time or part-time status.
- Geography.
- Seniority and hire date (for all positions with a company).
- Leave of absence history.
- Flexible work arrangement history.
- Performance reviews and ratings.
- Educational qualifications and any relevant training, licenses, or credentials.
- Prior job experience.
- Exempt versus nonexempt status.

Geographical information may be helpful in explaining that regional cost-of-living variations are driving pay disparities. Educational and similar qualification information, along with job experience, may also be helpful in providing a bona fide explanation for identified disparities. A company's performance reviews and ratings system should be grounded in objective and quantifiable information. This minimizes the risk that discretionary reviews and ratings are causing or reinforcing potential systemic disparities in employee compensation.

COMPENSATION INFORMATION

Companies must consider all forms of compensation and benefits when conducting a pay equity audit. A company's business model can impact its compensation model. For example, startup companies may rely on equity incentives and generous benefits rather than base salaries to attract and retain talent. Identifying all relevant compensation and benefits helps ensure a smooth employee data collection process and avoid false-positive or false-negative pay audit results.

An employee's base pay is generally the most important and obvious consideration. However, determining an employee's total compensation package involves an assessment of:

- Overtime pay.
- Incentive and performance-driven compensation, such as:
  - commissions;
  - bonuses;
  - profit-sharing plans;
  - equity interests; and
  - stock options.
- Employee benefits, including:
  - vacation time, especially in states like California, where accrued vacation and paid time off is earned and paid out as compensation when an employee leaves the company;
  - sick leave; and
  - medical, dental, and vision insurance benefits.

Companies should account for the various internal compensation models before analyzing the results of an audit. For example, some job groups may be compensated primarily using an incentive and performance-driven model where most compensation is paid at the end of a calendar year, while others may be rewarded by a generous benefits package that provides substantial paid time off or health benefits. These benefits carry monetary value and should all be considered when conducting a pay audit. Limiting an analysis to only base salary increases the risk of false-positive pay discrepancies.

Although an abundance of information is being collected and analyzed, a pay audit identifies potential pay discrepancies at a single point in time, thus limiting the time frame for which information is collected. If a company seeks a pay discrepancy analysis over an extended time period, a separate audit is performed for each individual point in time, whether on a yearly basis or otherwise.

IDENTIFY COMPARATOR JOB GROUPS

When determining which employees to compare, the employer must ensure that the employees who perform equal or substantially similar work are grouped together for review. This generally requires that the employees:

- Use equal or substantially similar skill, effort, and responsibility in the performance of their duties.
- Perform those duties under similar working conditions.

If a company lacks current or incorrect job descriptions, it should update them as part of the audit process. Job descriptions should clearly reflect the required duties of the job position and include the knowledge, skills, effort, responsibility, and working conditions required to perform the job (see Practice Note, Importance of Job Descriptions (2-616-6045)).

Identifying proper comparator job groups is crucial to a pay equity audit. If all employees in a department are grouped together without consideration of the skill, effort, responsibility and working conditions required of each position, a pay equity audit may find false-positive pay disparities that cause a company to unnecessarily remediate. For example, an entry level accounting employee may not be performing equal, or substantially similar, work as a senior accountant, who may also not be performing equal, or substantially similar, work to the chief financial officer. Grouping these employees together simply because they have finance and accounting roles will not deliver accurate pay equity results. Companies should consider using pay grades to formalize the distinct job requirements of different job positions (see Appropriate Pay Grades).

Appropriate Pay Grades

When no formal compensation structure exists, companies should consider establishing pay grades or pay bands that define compensation ranges for each position, including base salary, incentive compensation, and benefits. This can be implemented either before the pay audit is complete, when a company is reviewing its own internal processes while looking for potential causes of pay disparities, or after the pay audit is complete. Pay grades should account for numerous factors, such as:

- Job duties and responsibilities.
- Experience.

- Education.
- Geography.
- Any other objective and identifiable employee characteristic.

After setting up pay grades, employers then must consistently and accurately place employees, especially new hires, in the correct pay grade. Failing to place employees in the correct pay grade may cause them not only to be underpaid (or overpaid) relative to other employees who perform similar work under similar conditions, but also to miss out on job opportunities like promotions, trainings, and mentoring experiences. Once employees have been accurately placed in a pay grade, companies should also ensure that pay adjustments, whether through annual increases or off-cycle adjustments, consider the upper limit of an employee's pay grade. Companies should also strive to provide benefit packages that are consistent and commensurate with the company's compensation philosophy.

Appropriate Control Factors

In addition to identifying proper comparator job groups and implementing appropriate pay grades, companies should also have a clear understanding of what factors primarily drive compensation within a comparator job group. Objective factors like seniority, quantitative production, education, experience, and location are easy to track and are also recognized as valid job-related factors that can explain a pay disparity. Factors like qualitative performance, however, are also job-related but they are more prone to subjectivity and bias, which can result in tainted compensation outcomes. Companies should carefully scrutinize and document their compensation philosophy and the valid, job-related factors that can be considered when setting compensation. This will help address and mitigate the use of discretionary-based philosophies that may taint employee compensation and help to explain legitimate reasons for pay disparities. Although giving local management discretion to set employee compensation may seem appealing, especially for small companies, this can lead to problems as the company grows or the business structure changes.

AVOIDING ERRORS AND INACCURACIES

A pay equity audit is often, by necessity, an iterative process. Because of the large amount of data involved in conducting a pay equity audit, there is a risk that errors or inaccuracies in the collected data may not be revealed until the pay equity analysis has been performed. These errors or inaccuracies may produce outliers in the results that can be explained by local management or human resources. Rather than proceed with inaccurate results, companies should plan to correct any data errors or irregularities and rerun the analysis with corrected information.

Depending on the extent of these data challenges, the time and costs of a pay audit may increase with an iterative process. Companies should budget the time and capital expenditures to account for the possibility that the first pay equity analysis may simply serve as a test run. The iterative process allows a company not only to obtain more precise audit results, but also provides opportunities to identify core causes of any identified pay disparities that cannot be adequately explained and remedy those causes. For example, a company may learn that either:

- Extended leaves of absences are not tracked for performance, compensation, or other benefits purposes.
- Job title misclassifications are more prevalent than previously understood.

STATISTICAL ANALYSIS OPTIONS

Once a company has completed the data collection and privacy protection stages, it must decide which statistical analysis tools best serve its audit needs. This depends on the audit's scope, objectives, and budget and whether litigation is likely. The three most common analysis tools are regression, descriptive, discretionary review, and cohort analyses. Their purposes are to:

- Identify pay disparities.
- Identify legitimate explanations for any pay disparities.
- Provide information to correct unexplained and problematic pay disparities.

Employers typically use a regression analysis for larger comparator job groups, together with a cohort analysis for smaller groups.

Regression Analysis

A company that collects the full scope of information generally has a complete and descriptive set of employee data to begin its pay equity analysis. An abundance of information, however, can obscure the core causes of any pay disparities by failing to separate legitimate and unlawful explanations for these disparities.

A regression analysis is a statistical technique used to analyze the relationship between a dependent variable (compensation) and one or more independent, predictor variables. One of the most common regression analyses is a multivariate regression analysis, but its applicability is limited to large, heterogeneous groups of 30 or more employees. Another type of regression analysis is fixed-effects, which cannot control for variables that vary over time. A fixed-effects regression analysis is often recommended for small groups where a multivariate regression analysis is not likely to deliver reliable results.

The purpose of a regression analysis is to determine whether, after controlling for certain variables, any statistically significant pay disparities exist between employees with a particular protected character trait and similarly situated employees not sharing that trait. This method is commonly accepted by the courts in pay equity cases (see, for example, *Spencer v. Va. State Univ.*, 919 F.3d 199, 206 (4th Cir. 2019)). A regression analysis is therefore especially desirable if the employer is conducting the audit while defending or anticipating litigation (rather than proactively).

A regression analysis identifies the core causal contributors of pay disparities by:

- Isolating particular variables.
- Determining whether the variables are logically and statistically contributing to these pay disparities.

A regression model, however, allows a company to add multiple levels of analysis to incorporate additional variables like education, experience, and geography. After accounting for the differences among the variables, the regression then measures the compensation differences between protected and nonprotected employee classes.

For example, a review of the raw data may show that men are paid more than similarly situated women. Without further inquiry, this result ostensibly establishes pay discrimination based on gender. Performing a regression analysis, however, may provide a more accurate depiction of the true causal effect of gender on employee compensation. If men had an average of five more years of job experience than women, controlling for years of job experience may explain the difference in compensation between the men and women. This statistical analysis determines the extent to which prior job experience explains the pay gap.

Employers must make several key decisions when constructing a regression model, including:

- Whether to perform a single regression for the entire workforce or conduct a separate regression for smaller workgroups, keeping in mind that a regression analysis is generally not effective for analyzing small comparator job groups (typically with fewer than 30 employees) or heterogeneous groups that do not include a sufficient number employees of each gender (or other protected class).
- Which variables to include in the regression model.
- Whether to customize the model to address the requirements of a specific law.

Descriptive Analysis

When there are not enough employees in a population to conduct a regression analysis, employers may conduct a descriptive statistical analysis to assess pay disparities. It uses tools like simple averages, medians, variances, and correlations. This analysis traditionally focuses on one significant variable at a time to understand its effect on compensation. As a result, a descriptive analysis offers intuitive results, but does not offer the nuanced results of a regression analysis because the analysis does not simultaneously control for other variables.

Discretionary Review Analysis

A discretionary review analysis does not rely on averages, variances, correlations, regressions, or any other statistical tool to identify the causal contributors to pay disparities. Management performs a discretionary analysis by using a high-level consideration of variables, such as performance reviews, experience, and tenure.

This approach is not favored because it may not capture underlying causes of pay disparities and may further contribute to biased compensation policies executed with too much discretion. However, having strict guidelines for line management and human resources personnel to perform a discretionary review may help identify information that was not collected to assist in explaining any pay disparities, such as individual employee compensation decisions that were not formally reported.

Cohort Study

A cohort study is an additional tool used to analyze any pay disparities. A cohort study has inherently subjective elements and may also require more people hours to perform the analysis. Similar to a fixed-effects regression analysis, cohort studies are best used for smaller numbers of employees in a comparator group.

Generally, a cohort study requires the employer to sort employees in a similarly situated group into cohorts. One common cohort is an employee's year of hire into their position. By comparing similarly situated employees over a period of time, but with the same starting date, a cohort study may reveal whether certain employees are:

- Starting at a higher salary than other employees.
- Earning pay raises on a shorter timeline than other employees.

POST-AUDIT CONSIDERATIONS AND LONG-TERM SUSTAINABILITY

FOLLOW THE ESTABLISHED REMEDIATION PLAN

A company should respond to pay equity audit results according to its remediation plan. The plan should be thorough and flexible enough to address both the expected and unexpected outcomes. When developing its plan, the company should consider the timing of any remedial measures to be implemented, including whether they will be lumped in with traditional pay increases and over what period of time the company wants to achieve its pay equity goals. The remediation plan should also determine from the outset how the company will identify the disadvantaged employee groups within a comparator job group that will receive remedial pay adjustments.

Relatedly, employers may not reduce an employee's compensation to remedy pay disparities. Similarly, they should not freeze an employee's compensation as other employees' pay increases to come into alignment. Employers should instead rely on percentage increases and allocate larger percentage increases for disadvantaged employee groups.

REVISIT COMPANY POLICIES AND STRUCTURAL CONCERNS

Whether a company faces limited or widespread pay disparities, the best practice is to monitor and periodically revisit the company's job titles, descriptions, application documents, and employee handbooks. Employers should review and update, as necessary:

- Job titles and descriptions to ensure that job duties and responsibilities reflect the realities of the job's daily requirements. Large companies should also review job titles for consistency across offices, as inconsistent job titles may cause pay disparities that have legitimate explanations.
- Job applications and related documents to ensure that there are no prohibited salary history questions that may contribute to any pay disparities or violate applicable law. Under California and various other state and local laws, companies are prohibited from asking about an employee's salary history (for more information, see Practice Note, Discrimination Under the California Equal Pay and Fair Pay Acts: Salary History Ban (W-019-1008) and State and Local Salary History Laws Chart: Overview (W-011-0681)).
- Employee handbooks to accurately reflect a company's compensation philosophy and policies. For example, if employees may receive annual or periodic compensation increases based on their performance and other discretionary factors, the company may wish to include this in their handbook. The handbook need not disclose that a company is performing a pay equity audit.

Additionally, companies that use, or may use, pay bands or a compensation matrix should set the bands or matrix in a manner consistent with any recently implemented remediation compensation increases. These documents should provide compensation decision-makers with guiding principles to avoid the unlimited discretion that leads to pay disparities. Pay bands and other guidelines, however, should still allow a company to acknowledge and reward exceptional, or address subpar, employee performance. The key is to document and retain the objective and subjective reasons that an employee received a compensation increase or decrease.

COMMIT TO EDUCATION AND TRAINING

In addition to offering company management some guiding principles in setting employee compensation, the company should train management on the broader issues that relate to and impact pay disparities. These include training on:

- **Pay equity laws**. The company should train management, particularly those involved with the recruiting process and negotiating employee compensation, on the applicable pay equity laws in their jurisdiction and any jurisdiction where the company employs workers, even if the company is not presently undergoing a pay equity audit. Knowledge of the relevant laws can help management spot potential issues at the source.
- **Salary history bans**. Employers that hire in certain jurisdictions, including California, Connecticut, Delaware, Hawaii, Illinois, Massachusetts, Oregon, and Vermont, should train management, recruiting, and other hiring personnel about any applicable salary history bans that restrict a company's ability to request an employee's salary history at various stages of the hiring process. For more information on salary history bans and the jurisdictions that have adopted them, see Practice Note, State and Local Salary History Bans (W-005-9410) and State and Local Salary History Laws Chart: Overview (W-011-0681).
- **Unconscious bias**. Employers should train management on the dynamics and potential risks of unconscious bias and how their unintentional actions may have serious consequences for their employees' livelihoods.
- **Pay transparency**. Training management on pay transparency compliance is also crucial to ensuring long-term progress towards pay equity. Although there is no general federal pay transparency law, the National Labor Relations Act (NLRA) has long been interpreted to prohibit policies that prevent employees from discussing their wages. Similarly, states like California, New York, New Jersey, Massachusetts, and others have enacted legislation protecting employees' rights to communicate about their compensation and limiting a company's ability to control the manner of the employee's disclosure.

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