

HRCOMPLIANT

Are You Legally Exposed?

The Small Business HR Risk Guide

6 Areas Where Small Businesses Get Sued —
and How to Fix Them Before It Happens to You

By HRCompliant · hrcompliant.com

1 in 5

small businesses face an
employment claim

\$125k+

average cost to defend an
employment lawsuit

90%

of HR gaps are fixable before they
cost you

Most small business owners don't find out they have an HR problem until it shows up as a lawsuit, an IRS notice, or a state labor board investigation. By then, the cheapest fix costs \$10,000. The most expensive ones cost everything.

This guide covers the 6 most common — and most costly — HR exposure areas for businesses with 5 to 50 employees. For each one, we tell you what the risk is, what it costs, and exactly how to fix it.

WHAT'S INSIDE

Table of Contents

- 01 Hiring & Onboarding Mistakes**
The paperwork errors that create liability before day one

- 02 Contractor Misclassification**
The most audited HR issue for small businesses

- 03 Handbook & Policy Gaps**
The document you don't have — that will be used against you

- 04 Payroll & Overtime Errors**
The math mistakes that trigger back-pay claims

- 05 Multi-State Compliance**
What happens when your team crosses state lines

- 06 Area of Business Risk**
How your industry changes your compliance profile

- Your Next Step**
What to do with what you've learned

RISK AREA 01

Hiring & Onboarding Mistakes

Most HR lawsuits start before the employee's first day.

01 Missing or Incomplete I-9 Forms

CRITICAL

Potential cost: \$275–\$2,701 per violation (ICE audit)

What it means:

Every employee must complete Form I-9 within 3 business days of hire. Errors, missing sections, or late completion create per-employee fines. ICE audits target small employers.

How to fix it:

Audit your existing I-9 files. For new hires, create a Day 1 checklist that triggers I-9 completion before anything else. Store completed forms separately from personnel files.

Especially affects:

All industries · Hospitality & Retail · Staffing Agencies

02 No Written Offer Letter

HIGH

Potential cost: \$5,000–\$50,000+ in wage/contract disputes

What it means:

A verbal offer is legally binding but nearly impossible to defend. Without a written offer letter, disputes over salary, title, and at-will status become your word against theirs.

How to fix it:

Use a standard offer letter for every hire: job title, start date, compensation, at-will language, and any contingencies. Get a signed copy before the start date.

Especially affects:

Tech Startups · Professional Services · Any fast-growing team

03 Skipping Background Check Documentation

MODERATE

Potential cost: \$1,000–\$5,000 per violation (FCRA)

What it means:

The Fair Credit Reporting Act requires specific disclosures, consent forms, and adverse action notices. Most employers skip these steps.

How to fix it:

Before any background check: (1) standalone FCRA disclosure, (2) written authorization, (3) pre-adverse action notice if you decline. Document everything.

Especially affects:

Healthcare · Finance · Any role with financial or patient access

RISK AREA 02

Contractor Misclassification

The IRS estimates misclassification costs the federal government \$7 billion per year. They are actively looking for it.

04 Using 1099s for Workers Who Are Really Employees

CRITICAL

Potential cost: \$1,000–\$5,000 per worker + back taxes + penalties

What it means:

If a worker meets IRS behavioral or financial control criteria, they are likely an employee. Calling them a 1099 doesn't change the legal reality.

How to fix it:

Apply the IRS 3-part test: (1) Behavioral control, (2) Financial control, (3) Relationship type. When in doubt, classify as W-2.

Especially affects:

Construction · Tech Startups · Staffing · Professional Services

05 No Written Contractor Agreement

HIGH

Potential cost: \$10,000–\$75,000 in back wages if reclassified

What it means:

Without a contract, courts default to whatever provides the most protection to the worker. Even a correct classification needs documentation.

How to fix it:

Every 1099 worker needs a written agreement: scope, payment terms, IP ownership, NDA, and a statement that they are not an employee. Review annually.

Especially affects:

All industries

RISK AREA 03

Handbook & Policy Gaps

In most employment disputes, the first thing the opposing attorney asks for is your handbook. Without one, you lose your first line of defense.

06 No Anti-Harassment Policy

CRITICAL

Potential cost: Unlimited — eliminates your affirmative defense

What it means:

A documented anti-harassment policy with a clear reporting procedure is one of the only ways to establish an affirmative defense against harassment claims.

How to fix it:

Written policy must include: prohibited conduct, 2+ reporting channels, investigation process, confidentiality commitment, non-retaliation statement, and consequences. Get signed acknowledgments.

Especially affects:

All industries — required in many states

07 Handbook Not Updated in 3+ Years

HIGH

Potential cost: \$5,000–\$25,000 in state-specific compliance penalties

What it means:

A handbook from 3 years ago likely doesn't reflect current leave laws, pay transparency requirements, or remote work policies — many of which are now legally required.

How to fix it:

Review annually. At minimum check: paid sick leave language, salary history prohibitions, pay transparency requirements, remote work policy, social media policy.

Especially affects:

All industries · Multi-state employers

RISK AREA 04

Payroll & Overtime Errors

Wage and hour claims are the fastest-growing category of employment litigation.

08 Misclassifying Employees as Exempt from Overtime

CRITICAL

Potential cost: \$10,000–\$100,000+ in back wages + liquidated damages

What it means:

Not every salaried employee is exempt. The FLSA requires both a salary test (\$684/week minimum) AND a duties test. Calling someone a 'manager' doesn't make them exempt.

How to fix it:

Audit every salaried employee. Confirm salary threshold and duties test. Document your analysis. When in doubt, classify as non-exempt.

Especially affects:

Retail & Hospitality · Construction · Any business with salaried workers

09 Improper Final Paychecks

HIGH

Potential cost: \$500–\$30,000 per violation depending on state

What it means:

In California, involuntary termination requires final pay on the last day. Waiting until the next payday is illegal in many states.

How to fix it:

Know your state's final pay law before terminating anyone. Checklist: final pay calculation, accrued PTO payout, COBRA notification, equipment return.

Especially affects:

California employers · Multi-state employers

RISK AREA 05

Multi-State Compliance

The moment you hire in a new state, you've entered a new legal jurisdiction. Federal law is just the floor.

10 Missing State-Required Policies and Postings

CRITICAL

Potential cost: \$1,000–\$10,000 per state per requirement

What it means:

Every state requires specific workplace postings, policies, and in some cases mandatory training. These are not optional — and they vary significantly.

How to fix it:

For every state: (1) order current required posters, (2) review state sick leave laws, (3) check pay transparency requirements, (4) verify harassment training requirements.

Especially affects:

All multi-state employers · Remote-first companies · CA, NY, WA, CO employers

11 Applying One State's Rules to All Employees

HIGH

Potential cost: \$5,000–\$50,000+ across multiple violation types

What it means:

California employees have different meal break rights, overtime calculations, and PTO payout rules than Texas employees. One-size-fits-all creates violations in every other state.

How to fix it:

Build a state-by-state compliance matrix. Update it every time you hire in a new state. This is exactly what an HRCompliant audit produces.

Especially affects:

Multi-state employers · Remote teams

RISK AREA 06

Your Industry Changes Your Risk Profile

Beyond the universal risks above, your specific industry adds a compliance layer most generalist HR tools completely miss.

■ Healthcare

HIPAA training for all PHI-access staff · License verification · Strict overtime for clinical staff · Mandatory vaccination documentation

■ Construction

DOL #1 misclassification target · OSHA per job site · Prevailing wage on public contracts · Sub co-employer liability

■ Retail / Hosp.

Predictive scheduling (CA/NYC/Chicago) · Tip credit compliance · Minor labor laws · High I-9 volume from turnover

■ Tech Startups

Remote multi-state explosion · Contractor-heavy teams · Equity comp documentation · Rapid hiring without onboarding process

■ Logistics

DOT drug & alcohol programs · Hours-of-service records · Owner-operator classification · Multi-state driver compliance

■ Staffing

Joint employer liability · Per-assignment I-9 · ACA hours tracking across clients · FCRA compliance at volume

■ Professional Svcs

Contractor vs. employee blur · Non-competes (most now void) · Exempt status errors · Client-facing confidentiality policies

■ Non-Profit

FLSA applies fully · Grant-funded worker classification · Volunteer vs. employee line · 501(c)(3) board documentation

YOUR NEXT STEP

What to Do With What You've Learned

Step 1 Take stock

Rate yourself on each risk area: Red (problem exists), Yellow (not sure), Green (covered). Be honest.

Step 2 Fix the reds first

Start with the anti-harassment policy, I-9 audit, and contractor classification review. These three eliminate the majority of small business employment liability.

Step 3 Get a full audit

Your actual exposure depends on your specific states, industry, headcount, and setup. An HRCompliant audit gives you the complete picture — every gap, every state, with a prioritized action plan.

Ready to know exactly where you stand?

Get your free HR Compliance Audit — risk-rated, state-by-state, with a step-by-step action plan delivered in 3 business days.

hrcompliant.com/audit

Free intake · No commitment · Results in 3 business days

This guide is for general informational purposes only and does not constitute legal advice. Employment laws vary by state and change frequently. Always consult a licensed employment attorney. HRCompliant is not a law firm.