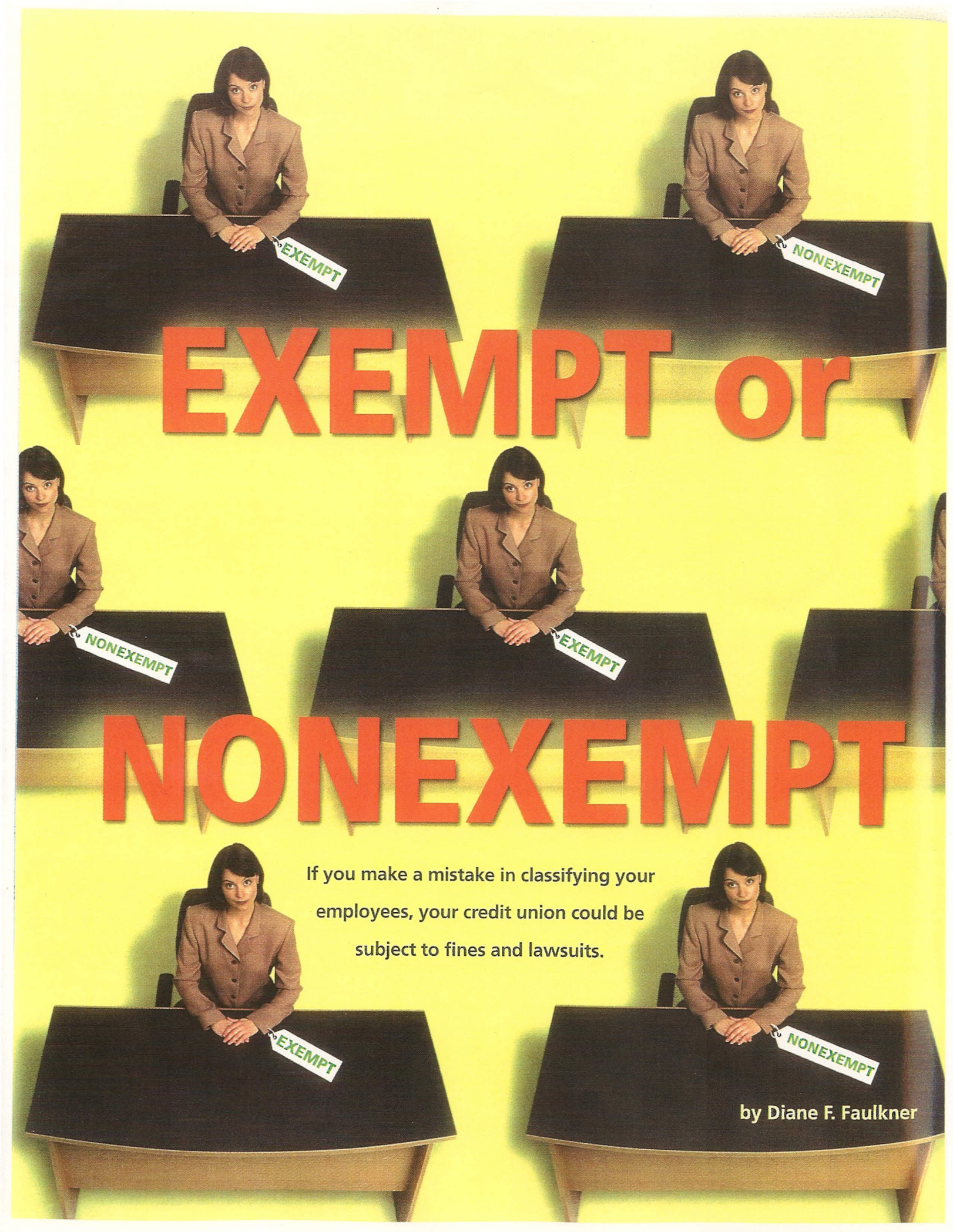

EXEMPT or NONEXEMPT

If you make a mistake in classifying your employees, your credit union could be subject to fines and lawsuits.

by Diane F. Faulkner

Are your tellers/member services reps exempt or nonexempt employees? What about your loan manager? You answered those questions pretty quickly, didn't you? Now answer this: Are you sure you've correctly classified your reps and manager—or any other employee for that matter?

If you hesitated, if you've agonized over the Fair Labor Standards Act's rules and tests for classifications, if you've made mistakes in classifying employees, you aren't alone. The Fair Labor Standards Act (FLSA) was enacted in 1938 as a means of ridding the country of employment abuses related to child labor, low wages and excessive work hours. But in the 65 years since its enactment, FLSA has generated a fair amount of confusion over the proper classification of employees.

It's not surprising then that, earlier this year, when the U. S. Department of Labor (DOL) issued a call for comments on several proposed revisions to the FLSA, human resource practitioners across the country began revisiting how the act impacts their work. Some of the questions being asked were: Will the proposed changes make the act easier to administer? Will the administrative exemption be less abused?

Why have FLSA?

The FLSA is the best defense against rampant unemployment and unfair wages. As written, it forces employers to critically evaluate positions, not only on paper to determine worth to the company, but also in practice to ascertain when the scope of a position's activities result in a decline in productivity, providing incentive to create new jobs.

The evaluations are what drive the act's tests, which make up its core. (The FLSA has five exemption categories and there is a test employers use to determine if a position fits into one of them.) Weaken any part of the tests, and we risk weakening our economy, which is why the DOL made a particular effort to solicit comments from those affected by FLSA before actually making changes.

Unfortunately, the tests can be variously interpreted when not supported by definitions and clarifications found embedded in sub-subsections throughout the act. By not referencing the text to brace the tests, misclassifications result. "Of all the white-collar exemptions," notes Robin Griewe Midulla, labor attorney with the Florida offices of Constangy, Brooks and Smith LLC, "the administrative exemption is the one that is most frequently wrongly applied by employers."

Midulla explains, "The description of one who fits within the exemption looks clear enough; however, when viewed through [DOL's Wage and Hour Division's] interpretive lens, an employer's determination is often disqualified as an improper fit."

Take a look at the Administrative Exemption Test (see box A). To help clarify confusing classifications, the

(box A) Administrative Exemption Test

	Long Test	Short Test	Proposed Standard Test
$$	Pay floor: $155 wk	Pay floor: $250 wk	Pay floor: $425 wk
DUTIES	**Duties Primary Duty:** Performing office or nonmanual work directly related to management policies or general business operations of the employer or the employer's customers. Customarily and regularly exercises discretion and independent judgment. Regularly and directly assists a proprietor, or exempt executive or administrative employee; *OR* performs specialized or technical work requiring special knowledge under only general supervision; *OR* executes special assignments under only general supervision. Does not devote more than 20% (40% in retail or service establishments) of time to activities that are not directly and closely related to exempt work.	**Primary Duty:** Performing office or nonmanual work directly related to management policies or general business operations of the employer or the employer's customers. Customarily and regularly exercises discretion and independent judgment.	**Primary Duty:** Performing office or nonmanual work directly related to management or general business operations of the employer or the employer's customers. Holds a "position of responsibility" with the employer, defined as either (1) performing work of substantial importance or (2) performing a high level of skill or training.

DOL attempts to enhance the subjective phraseology in the duties tests that results in misclassification by employers and inconsistent application of the exemptions by investigators and the courts.

A key component in determining exempt status is the basis upon which an employee is paid. This is where a variety of managerial personalities invite trouble, because *salary basis* gets confused with *social status*. Attitudes toward position-worth insinuate, however unintentionally, into attitudes toward people populating positions.

According to Amy Aylward, vice president of human resources for $182 million Sandia Area FCU in Albuquerque, N.M., manager and employee unfamiliarity with the act and its nuances, coupled with perceptions of worth surrounding jobs, compound difficulties complying with FLSA.

"When HR discovers someone has been treated as exempt when s/he is clearly in a nonexempt job," Aylward explains, "the problem has to be corrected." [If not, the credit union opens itself up to risk of possible fines during a government audit or even a class action suit if reported to the wage and hour division.]

"Try explaining that to the salaried employee. Most exempt employees are in management. Employees equate being salaried with being part of the upper echelon. An employee being told that s/he will now have to be paid hourly and start punching the clock feels demoted. Even when you explain that paychecks will actually be bigger due to overtime earnings and that more cash will end up in the 401(k), for some people the perceived status is worth more than the money."

In her 2003 Labor and Employment Law Workshop, Midulla warns employers to remember that courts "often apply what is known as the administrative/production dichotomy in determining whether the primary duties of the employee's position qualify for the exemption. The test involves distinguishing between those employees whose primary duties include administering the business affairs of a company versus those employees whose primary duties [involves] producing the goods or services that are sold by the business."

Production gets interpreted too narrowly by employers to reflect end product rather than routine activities. The phrase "administering the business affairs of a company" gets translated in such a way as to include clerical positions as exempt when just the opposite is true.

Practical challenges

Midulla points out that "an employee performing routine clerical duties, although exercising independent judgment and discretion to a certain extent, is not performing duties directly related to the management of the business."

Think of this in terms of an accounting manager preparing a board report, the format of which is repeatedly used but only updated, not created. The calculations for the report are prescribed macros in a spreadsheet and numbers can be plugged in at a nonexempt level. The interpretation of and projections from the information gathered is the only exempt work in updating such a report, and that work is generally done by a CFO.

Multiply the number of standard reports used by managers, factor in the time spent on nonexempt tasks, and it becomes clear how the current rules disqualify many managers from being classified as exempt.

A key phrase, "discretion and independent judgment," is regularly misinterpreted. It is defined as judgment that "must be real and substantial, [and] must be exercised with respect to matters of consequence." Midulla explains that for human resources this means that pre-

(box B) Weekly Salary Levels Comparison

Current Rule	
Long Test	Executive Employees - $155 Administrative Employees- $155 Learned Professionals - $170 Creative Professionals - $170 Computer Employees - $170 Outside Sales – No requirement
Short Test	Executive Employees - $250 Administrative Employees - $250 Learned Professionals - $250 Creative Professionals - $250 Computer Employees - $250 Outside Sales – No requirement
Section 13 (a)(17) Test	Computer Employees - $27.63 hr.

Proposed Rule	
Standard Test	All Categories - $425 *Except:* Computer Employees - $425 wk or $27.63 hr Outside Sales – No requirement
Highly Compensated	$1,250

Online Resources

To learn more about the FLSA and view the full proposed changes to the act, go to **www.dol.gov.**

screening and rejecting applicants according to predefined standards is not exercising independent judgment and discretion, whereas hiring, firing, and solving problems on one's own is both independent and directly related to managing the business. The percent limitation under the current rules provides incentive to develop managers and other staff in this phase of recruitment.

Under the current rules, the percent limitation on time spent performing nonexempt tasks plays a key role in determining when a position remains exempt, switches to nonexempt or fractures into multiple jobs to be done internally, externally or as a combination of both. This provision, as originally written, forces employers to create new jobs, which remains one of the intentions of the law. Limiting time to perform specific tasks at certain levels affects overtime and forces employers to recognize when overloading positions is costlier than creating new positions.

Salary basis increases

The salary basis tests have remained unchanged since 1954, though there are levels that were last updated in 1975. The current rules have "long" salary tests that don't match corresponding "short" tests within the same classification.

The DOL's proposed regulations raise the salary threshold, which has always been a major component in classifying positions as exempt, from $155 to $425 a week.

The $270 increase would be the largest since the FSLA's passage in 1938. According to the DOL, the proposed change would increase the wages of 1.3 million low-income workers and reduce the number of low-wage salaried workers currently denied overtime compensation. The new minimums were figured at the lowest 20 percent of salary ranges reported in the Bureau of Labor Standards' year *2000 Current Population Survey Outgoing Rotations Data Set.*

The update also introduces a "super salary test" for qualified employees. These highly compensated personnel would qualify for the executive, administrative or learned professional exemptions if they:

- perform office or nonmanual work,
- are guaranteed total annual compensation of at least $65,000, and
- perform one or more of the exempt duties in one of the three classifications.

(Note: Base salary, commissions and nondiscretionary pay, including bonuses, may be used in the calculation for total annual compensation.)

Clarifications and translations

To help employers avoid testing traps, the proposed rules clarify the type of work performed that can be considered "office or nonmanual." (See box C for the job types included in the proposal.)

The "position of responsibility" requirement is defined to reduce the contradictory emphasis previously placed on production versus staff when differentiating between exempt and nonexempt positions. Employees meeting this requirement will customarily perform work of "substantial importance" or work "requiring a high-level of skill."

The substantial importance phrase, while not previously highlighted in the DOL grids, has actually been part of the interpretive guidelines since 1950. This kind of work is defined to mean that which "by its nature or consequence, affects the employer's general business operations or finances to a significant degree." Examples of this activity included in the proposed changes include:

- Formulating, interpreting or implementing management policies.
- Providing consultant or expert advice to management.
- Making or recommending decisions that will have a substantial impact on general business operations or finances.
- Analyzing and recommending changes to operating practices.
- Planning long- and short-term business objectives.
- Analyzing data, drawing conclusions and recommending changes.
- Handling complaints, arbitrating disputes or resolving grievances.
- Representing the employer during important contract negotiations.

"Work requiring a high level of skill or training" is defined as work requiring specialized knowledge or abilities or advanced training that can be acquired through academic instruction or advanced on-the-job training. This is a reversal of the DOL's previous view that using a reference manual indicated performing nonexempt duties. If the changes are approved as published, use of a manual that contains highly technical, scientific, legal, financial or similarly complex information that *can be interpreted only by those with advanced*

(box C) Types of work considered "office or nonmanual"

Accounting	Human Resources	Public Relations
Advertising	Labor Relations	Purchasing
Auditing	Marketing	Quality Control
Employee Benefits	Personnel	Research
Finance	Management	Safety and Health
Government Relations	Procurement	Tax

training or specialized knowledge or skills will be regarded as exempt work

For credit unions, this means the loan officer position again comes under scrutiny, even though, Aylward notes, "In 1999, the DOL issued an opinion letter that loan officers are nonexempt, because the job is a 'line' or 'production' function, not a 'staff' or 'administrative' function. The Society for Human Resource Management (SHRM) is lobbying for loan officers to be classified as exempt."

She continues, " It's a little humorous that the DOL states in one paragraph that job titles alone cannot determine exemption, yet they devote several paragraphs to and solicit comments on how some individual titles should be treated. A loan officer is a very different job in the mortgage industry compared to commercial banking or credit unions. I think it's important to stick to the primary duty test.

"Even with the proposed improvements," Aylward says, "many aspects of FLSA are still open to interpretation. Supervisor and loan officer positions at my credit union are nonexempt. When the final regulation is issued, I'm not going to fire up my laptop and start changing those two classifications."

Perceptions

"Another problem I experience," Aylward continues, "is dealing with management's perception of FLSA. Especially when faced with an exempt employee who is perceived as taking advantage of the exemption. For example, if an exempt employee frequently works six-hour days instead of eight-hour days, management wants to exact discipline by making the employee punch the clock instead of using appropriate discipline or performance management. HR's challenge is explaining court decisions on practices with hourly attributes being ruled inconsistent with the salary basis requirement of FLSA. If a person is treated [as an hourly employee], the position looks hourly, smells hourly [and] it's ruled nonexempt."

Exempt work is salaried, because the compensation does not represent time spent on the job or even at work, but rather the general value of a body of knowledge to an organization. This statement remains true, regardless of any change to the FLSA.

Under current rules, if an exempt employee is docked for any portion of a workday, whether for variations in the quantity of work performed—especially when hourly increments are at issue—or for discipline, absence or tardiness, including partial day deductions from leave time, that position loses its exemption across the board. Such a loss means backtracking payroll records to find when improper deductions began, figuring up (estimating) lost overtime to be paid to all employees in the same job classification, and then continuing to pay the formerly exempt positions as nonexempts until pay classifications are reviewed. (A good reason to have an annual review).

The new rules describe a safe harbor, which would amend this to paying employees in the same classifications under the same manager making the error from the time the improper deductions began until they ended.

The new safe harbor, if approved, would protect the exempt status if the employer has a written policy prohibiting pay deductions; employees are notified of the policy; and the employer doesn't repeatedly and willfully (pattern and practice) violate the policy or continue to make improper deductions after receiving employee complaints.

Under the proposed changes, docking would be allowed only:

- when an exempt employee is absent from work for a full day for personal reasons other than sickness or disability;
- for absences of a full day or more occasioned by sickness or disability (including work-related accidents) if the deduction is made in accordance with a bona fide plan, policy or practice of providing pay for salary loss for sickness or disability;
- when an exempt employee violates safety rules of major significance;
- when, in good faith, an exempt employee is suspended for a full day or more for infractions of workplace conduct rules;
- for initial and terminal weeks of employment; and
- when an exempt employee takes unpaid leave under the Family and Medical Leave Act.

Additionally, the pay employees receive as jury fees, witness fees or military pay for any particular week may be offset without exemption loss as long as there are no deductions for absences.

"Until changes are made," Midulla warns, "employers should be aware that the plaintiffs' bar has finally realized the fertile feeding ground that lies in wage and hour class action suits. Employers must be diligent to annually review pay classifications and seek labor counsel advice to ensure that employees are properly classified as exempt."

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Comp time

One question HR folks are asking about the proposed changes to the Fair Labor Standards Act is whether compensatory time will finally be allowed outside the public sector?

The answer: No.

The proposals do not address "comp time." Separate legislation allowing private sector employees to receive compensatory time was introduced as HR 1119—the Family Time Flexibility Act, but has since been set aside.

Compensatory time remains a public-sector only privilege, so if your credit union allows staff to save up hours one work-week to take time off another work-week, stop it. You're out of compliance.