



# Understanding the Fair Labor Standards Act

## *Facts & Fiction of FLSA Compliance*

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Over the years, compliance with state and federal regulations, and compliance with union contracts, has become more complex and more difficult to manage, resulting in costly legal actions for many employers.

The Fair Labor Standards Act (FLSA) directly affects all employers that engage in interstate commerce or the production of goods for interstate commerce, hospitals, schools, and public agencies, regardless of size. The only employers who are exempt from this legislation include small businesses not engaged in interstate commerce and have an annual gross revenue under \$500 thousand.

Many employers have a false sense of security and assume that their timekeeping or payroll software systems support FLSA, but this is not the case. A recent survey shows 73-percent of the employers polled rated their ability to manage compliance good to excellent, but U.S. Department of Labor (DOL) audits and other research shows 48 to 75-percent of employers are not compliant with some or all of these regulations. Understanding the regulations and implementing the required processes and calculations is key to ensure compliance and avoid costly problems.

## Understanding the Fair Labor Standards Act

FLSA is the federal law that governs how employers handle wages and payments to its employees. Here are some of the key provisions of FLSA:

- Requires employers to classify employees as exempt or non-exempt; as a rule, professional and managerial employees are exempt and all other employees are classified as non-exempt.
- Requires employers to accurately and fairly capture and record the hours worked by non-exempt employees each day, even if they are paid a salary.
- Requires employers to pay overtime to non-exempt employees at 1.5 times the employee's regular rate; a common misconception and source of error is that the regular rate is simply the base hourly rate.
- Allows employers to pay a salary to all employees, including non-exempt employees, but does not relieve the employer's obligation to pay overtime to non-exempt employees.
- Requires employers to recalculate payroll and overtime payments for weeks already paid if a non-discretionary bonus payment is related to hours worked in prior weeks.
- Allows payments to employees to be done on a piece rate or other incentive, but it does not relieve the employer from paying overtime.
- Requires employers to pay employees for work time and other time spent preparing for work.
- Regulates the minimum wage and work hours for minors.

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## Salary & Fees

One of the qualifiers of an exempt employee is that the employee must earn a minimum salary or fee of \$455 per week. However, there are exceptions, such as a computer employee who passes the duties test (see Exemptions below) and earns a minimum of \$27.63 per hour. Outside sales, teachers, lawyers, doctors, medical interns or medical residents do not have to meet the minimum salary requirement of \$455 per week to be exempt. Employees who earn more than \$100,000 per year may be exempt as a highly compensated employee, as long as they perform one of the duties tests on a routine basis. Any employee who is not on a salary, regardless of amount paid, is not an exempt employee and is subject to overtime pay.

Employers must adhere to specific conditions when paying employees a salary or the employees' exempt status may be compromised. A salary employee receives a predetermined amount of pay each period, making up at least part of the employee's compensation. The employee's pay cannot be reduced due to variations in the quality or quantity of work, so a salary employee must receive a full salary for any week the employee performs any work, without regard to the number of days or hours worked. However, the employee does not have to be paid for any workweek that he/she does not work. When an exempt salary employee works on a weekend or after business hours, the employer is not expected to offer comp time or pay overtime. Salary, exempt employees are expected to work when needed.

For an employee who is paid on a fee basis and has an exempt status, the fee must equal at least \$455 per week based on 40 hours. For example, if an employee was paid \$300 for 30 hours of work, the employee would not be considered exempt, because if the employee was paid for 40 hours of work it would equal \$400, not the required \$455.

## Deductions

There are very few reasons for deducting an exempt employee's pay. Deductions can be the consequence for violating major safety rules that put the workplace or other employees in danger. The DOL lists smoking in explosive plants, oil refineries, and coalmines as an example. The employer must also have a written policy on suspension without pay for violating safety rules, sexual harassment, or violence. However, deductions can only be made in full day increments; employers cannot pay an exempt employee for a partial day. If an employer does pay an employee for a partial day, the employer can jeopardize the exempt status for that employee and other employees in the same category. This could result in retroactive overtime pay for these employees.

When an exempt employee calls in sick and there is not enough paid time-off (PTO) available, the employer can deduct a full day of pay if it is in compliance with a legitimate plan, policy, or practice of deducting the salary for this type of sickness or disability. On the other side, half-day increments can be subtracted from an exempt employee's available PTO, but half-day pay cannot be subtracted.

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## Exemptions

Employers must first classify employees as exempt or non-exempt. Often times, employers classify employees based on job title, but that can cause several issues. Exemption status has nothing to do with titles, and everything to do with job description, job functions, and duties. Just because an employee's title states manager, it does not automatically classify the employee as executive exempt, and administrators are not automatically classified as administrative exempt. There are specific duties an employee must perform to be exempt, as there are various types of exemption roles.

### *Executive Exemption*

To classify an employee as an executive exemption, the employee must meet the following three criteria:

1. Primary duty must be management
2. Must have two full-time direct report employees; this can also be four part-time employees, or one full-time and two part-time employees, as long as it equals two full-time reports
3. Must have the authority to hire and terminate, or have a significant influence on the decision

In many instances, employers are not aware of what is considered management duties, which can result in misclassification. According to the DOL, the following are management duties:

- Interviewing, hiring and training
- Establishing and adjusting pay rates and work hours
- Disciplining employees
- Managing employee complaints and grievances
- Allocating work among employees
- Directing and planning employee's work as well as what techniques should be used
- Selecting materials, supplies, machinery, equipment, and/or tools for a job
- Selecting goods to be bought, stocked and sold
- Controlling production and distribution of goods, material and supplies
- Recommending promotions or other changes in an employee's status
- Providing a safe and secure work environment for employees or protecting the property
- Budget planning and control
- Oversee legal compliance measures

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## ***Administrative Exemption***

There are two main duties that an administrative exempt employee must do on a daily basis (1) perform office or non-manual work directly related to the management or business operations and (2) use discretion and independent judgment regarding matters of significance, such as:

- Authority to formulate, affect, interpret or implement management policies or operating practices
- Manage major assignments directly related to business operations
- Perform work that significantly affects business operations
- Authority to commit the employer when there is a significant financial impact
- Authority to waive or change from established policies and procedures without getting approval
- Authority to negotiate and bring together the company when important issues arise
- Provide management with expert advice
- Participate in long term or short term business planning
- Investigate and resolve issues on behalf of management
- Represent the company by handling complaints, arbitrating disputes or resolving grievances

Team leaders who manage key projects for the employer, not small projects, also fall under the administrative exemption, but these employees must have authority over matters of significance as well.

## ***Professional Exemptions***

There are two types of professional exemptions:

- Learned professionals – employee’s work requires higher education to perform the job, and must have academic training or degree
- Creative professionals – employee’s work requires invention, imagination, originality, or talent in a recognized artistic or creative profession; for example, actors, musicians, composers, conductors, soloists, painters only given a subject matter, cartoonists who express their own concept, and writers who choose their own subjects

## ***Computer Exemptions***

For an employee to fall under the computer exemption status the employee must be a computer systems analyst, computer programmer, software engineer, or other skilled worker in the computer field; the employee must also qualify for one of the following responsibilities:

- Application of systems analysis techniques and procedures, including consulting with users to determine hardware, software, or system functional specifications
- Design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specification
- Design documentation, testing, creation or modification of computer programs related to machine operating systems
- Or, a combination of any of the above

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Computer employees involved in computer hardware and equipment repair, purchasing software, providing advice a person can obtain from a manual, and other employees who heavily rely on the computer but are not analysts or programmers.

### ***Outside Sales Exemption***

There is no salary threshold for the outside sales exemption, but the employee must pass the duty test. The salesperson must be regularly out of the office every week. This does not include sales made solely by mail, telephone, or Internet.

### ***Inside Sales Exemption***

An inside sales exemption employee must be employed by a retail or service establishment; the pay rate is more than 1.5 times the minimum wage; and, more than half the employee's compensation over a one month period, must represent at least one month of commissions on goods or services.

### ***Specific Jobs Exemptions***

Here is a list of specific jobs that fall under the exemption category as long as the employee meets the specific requirements including the salary threshold:

- Executive Secretary – typically yes, when reporting to a business owner or senior executive of a large business, but the administrative exempt qualifications must apply; the employee's primary duties cannot be clerical, recording or tabulating data, or performing repetitive and routine work
- Chefs – executive chefs and sous chefs with a four-year degree in culinary arts; cooks who complete routine and manual work are non-exempt
- Teachers & Academic Personnel – these employees fall under the administrative & professional exemption, but they must earn the minimum salary threshold that is equal to the entrance salary for teachers in the educational establishment where they are employed
  - Professional exemptions include: regular academic teachers, kindergarten or nursery school teacher, gifted or disabled child teacher, teacher of skilled and semi-skilled trades and occupations, auto driving instruction teachers, flight instructions, home economics teachers, vocal or instrumental music teachers, and faculty members who are teachers but spend a lot of time involved in the extracurricular activities
- Insurance Claims Adjusters – the employee must conduct interviews with the insured, witnesses and physicians; inspect property damage, review information to create damage estimates, evaluates claim coverage, liability and total value; negotiate settlements, and make litigation recommendations
- HR Personnel – the employee falls under the administrative exemption if he/she prepares, clarifies, or executes employment policies
- Financial services – the job must includes collect and analyze data regarding customer's income, assets, investments, or debts; and, recommend and advise on financial products to meet the customer's needs and financial circumstances
- Athletic Trainers – considered exempt if the employee completed four academic years of study in a specialized curriculum accredited by the Commission on Accreditation of the Allied Health Education Programs and who are certified by the

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Board of Certification of the National Athletic Trainers Association Board of Certification

- Buyer – considered an exempt employee if given the authority to exercise independent judgment by committing the company to the purchase of a substantial dollar amount of raw materials; but, if the buyer has a low dollar amount to work with, then the employee is not exempt

### ***Specific Jobs Non-Exemptions***

Here is a list of specific jobs that fall under the non-exemption category

- Public Sector Inspectors or Investigators
- HR Recruiters
- Paralegals
- Accounting Clerks and Bookkeepers
- Engineer without a degree
- Blue Collar Workers: maintenance, construction, carpenters, electricians, mechanics, plumbers, iron workers, craftsman, operating engineers, longshoremen, hazardous materials workers, laborers
- Registered Nurses

## **Jeopardizing Exempt Status**

The most common way for employers to jeopardize exempt status for an entire class of employees is from incorrectly deducting pay from an exempt employee. For an employer to lose exempt status by making improper deductions, there are several factors to consider:

- Time period employer made improper deductions
- Number & geographic location of employees whose salaries were improperly reduced
- Number & geographic location of managers responsible for taking improper deductions
- Whether the employer has a clearly communicated policy permitting or prohibiting improper deductions
- Number of improper deductions compared to the number of employee infractions deserving discipline

Employers that do not show a habit of making incorrect deductions will not lose the exemption as long as the employer reimburses the employees. However, if the employer willfully violates the policy by continuing to make improper deductions after receiving employee complaints, the exemption will be lost during the period of improper deductions.

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## Safe Harbor Policy

The safe harbor policy helps protect employers from losing exempt status by:

- Having a communicated policy that includes a complaint mechanism and prohibits improper pay deductions
- Reimbursing employees for any improper deductions that have occurred
- Making a good-faith commitment to comply with the regulations in the future

## Compliance with WorkForce Software's EmpCenter

WorkForce Software's consultants and EmpCenter™ software ensure compliance so employers do not have to be bothered. Processes and calculations that can cause non-compliance are controlled and automated through EmpCenter. Our consulting services go beyond the traditional software implementation. Our consulting team is made up of true industry experts who help customers integrate workforce management Best Practices into their business processes. Through a discovery session with your organization, our consultants identify your core needs, provide detailed recommendations to improve processes, and ensure federal and state compliance.

Navigating this minefield of regulations has put over 50% of employers out of compliance. WorkForce Software's consultants have extensive expertise in FLSA. Prior to implementing EmpCenter, consultants examine how the employer currently administers time and labor processes to ensure compliance once the software is installed.

EmpCenter accurately and fairly captures hours worked, ensures required overtime is paid, automatically calculates correct overtime rates, and properly handles non-discretionary bonus payments. WorkForce consultants provide employers with best practice recommendations for successful compliance.

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**LEGAL NOTICES**

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