

NONPROFIT RISK MANAGEMENT CENTER

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Exempt or Non-Exempt

How to Answer the Question

(and why to ask)

A Risk Management Webinar

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Exempt or Non-Exempt? How to answer the question and why to ask

During this Webinar we will address the commonly posed question: “Is this employee exempt or non-exempt?” and perhaps more importantly, we will respond to the question, “Why does it matter?” To address why it matters, we will explore the risks created when employers either do not identify whether employees are exempt or non-exempt, as well as the risks that can derail an organization when workers are misclassified. We will also briefly discuss the risks of misclassifying workers as independent contractors or consultants, when the federal or a state government would classify them as employees.

This Webinar presentation is intended to provide guidance on how a nonprofit organization can conduct a self-check to identify any problems that may exist in classification of workers but it is not intended to replace competent legal advice. The Center strongly encourages nonprofit organizations that have continuing concerns or questions about this issue to engage the services of an experienced employment lawyer to provide more specific guidance.

What is the significance of the “Non Exempt” Classification?

- ❖ Employees whose positions are classified as “non-exempt” are owed extra compensation (“premium pay”) for extra time worked (“overtime.”)¹ Non-exempt employees are generally required to work a certain number of hours each day, to keep track of their hours and to get authorization for unpaid time off.

What is the significance of the “Exempt” Classification?

- ❖ There is no obligation to pay premium pay to exempt employees for “overtime.”
- ❖ Exempt employees ideally have the mindset that they will work however many hours it takes to get their job done, and not focus on the actual hours worked.
- ❖ Exempt employees are permitted flexibility in the hours they work to meet the needs of the organization and the requirements of their performance goals, balanced by the needs of the individual employee.
 - ⇒ Example: If an exempt employee has a doctor’s appointment in the middle of the day, the employee takes time out from work to attend the appointment but does not specifically “make up” the time away from the office *hour for hour*. Instead, there is an expectation that the employee’s work will get done even if the employee has to work in the evening at home to get it done.
 - ⇒ In contrast, if a non-exempt employee has the same doctor’s appointment, she would “sign out” on her time sheet when she left work, and sign in upon her

¹ Overtime (time worked in excess of a regular workweek) is defined differently state by state. For federal wage purposes “overtime” is time worked in excess of 40 hours in one work week.

return, and not get paid for the time out of the office – OR – arrange with her supervisor to work an additional amount of time that same week, the equivalent of the time she spent going to the doctor’s appointment (“flex time”).

Why does it matter whether a worker is classified as exempt or non-exempt?

- ❖ It matters because there are direct financial implications for *failing to pay a non-exempt worker for all time worked and for overtime*. The nonprofit will owe both compensation for the time worked as well as the withholdings that were not paid to the state or federal government on the wages that were not paid.

What are the key laws that govern this area?

- ✓ [Fair Labor Standards Act of 1938 \(FLSA\)](http://www.dol.gov/esa/regs/fedreg/final/2004009016.htm), as [recently amended in 2004](#), [hyper link to URL: <http://www.dol.gov/esa/regs/fedreg/final/2004009016.htm>) ([29 USC §201 et seq.](#); [29 CFR Parts 510 to 794](#))
- ✓ State specific Wage and Hour regulations that define: (a) minimum wage; (b) how many hours constitute a regular work week before the work is considered to be “overtime;” (c) the characteristics of exempt employees; and (d) who is an employee versus who is an independent contractor/consultant.

What do the laws require?

The FLSA and state wage and hour laws establish standards for minimum wages, overtime pay, recordkeeping, child labor and also define which workers are independent contractors as opposed to employees.

Minimum Wage

The current minimum wage established by the federal government is \$5.15 an hour. Each state may also establish a minimum wage. (Most states’ minimum wages exceed \$5.15 at present.)²

- Every employer subject to the Fair Labor Standards Act’s minimum wage provisions must post, and keep conspicuously posted, a notice explaining the Act in a conspicuous place in all of their establishments. The posting can be obtained from the DOL at the following website: <http://www.dol.gov/esa/regs/compliance/posters/flsa.htm>.

Your workplace is covered by the FLSA if it is “engaged in interstate commerce” and if it has a total dollar ‘volume of business’ of \$500,000. While almost every nonprofit organization can be said to be engaged in interstate commerce, not every organization will meet the threshold dollar

² Eighteen states have a higher minimum wage than the federal government; Nebraska is the only state with a minimum wage lower. Georgia, Tennessee, Alabama, Mississippi, Louisiana and Nevada have no minimum wage. The remaining states share the federal minimum wage rate.

amount of the “business volume” test.³ Consequently, the FLSA may not apply to your organization. However, state laws will apply, that most often mirror the federal law, with some exceptions.

Both federal and state wage and hour laws require that all employees (with minor exceptions for student workers and individuals whose earning or productive capacities for the work to be performed are impaired by physical or mental disabilities, including those related to age or injury) receive a **statutory minimum wage** for all work performed—and that employees who are not otherwise exempt—receive **premium pay** for each hour worked in excess of what the applicable law has determined to constitute “**overtime.**”

⇒ Note that the FLSA defines “overtime” as time worked in excess of 40 hours in a single work week. Some states use a different definition. *Example:* (a) In *Colorado*, overtime must be paid for any work in excess of 12 hours per workday as well as for any time worked in excess of 40 hours in a workweek; (b) In *Maryland*, premium pay is required for residential employees of institutions primarily engaged in the care of the sick, aged or mentally ill after 48 hours worked in a week; (c) In *Kentucky*, premium pay must be paid for the seventh day of work for those employees who regularly work seven days a week; (d) In *Minnesota*, overtime must be paid after 48 hours of work in a single week; (e) In *Montana*, overtime must be paid for any work over 8 hours a day, unless the employee and employer have mutually negotiated to work four 10-hour days in a work week, (e) In *Alaska*, overtime is not required for workplaces with fewer than four employees.

Premium Pay Required for Overtime Worked

The FLSA requires employers to pay employees not less than one and one-half times their regular rates of pay for all hours worked in excess of 40 in a workweek, unless the employees are otherwise exempt. In contrast, some state laws do limit the number of hours worked in a day and some define the work week or overtime differently that does the FLSA.

⇒ Consequently, it is important to be familiar with your specific state wage and hour regulations.

⇒ When an organization is covered by federal law and the applicable state law is more stringent, the state law should be followed.

The FLSA does NOT limit either the number of hours in a day or the number of days in a week that an employer may require an employee to work, as long as the employee is at least 16 years old. Similarly, the FLSA does not limit the number of hours of overtime that may be scheduled.

³ The following employers are covered by the FLSA regardless of their dollar volume of business: hospitals; institutions primarily engaged in the care of the sick, aged, mentally ill, or disabled who reside on the premises; schools for children who are mentally, or physically disabled or gifted; preschools, elementary, and secondary schools and institutions of higher education; and federal, state, and local government agencies.

Exempt or Non-Exempt?

So, which employees are exempt? The FLSA and state DOL wage and hour regulations define which positions are exempt. If the position does not meet the criteria established in wage and hour regulations, the position must be classified as non-exempt (hourly). The FLSA was recently amended (April 2004) in an attempt to clarify this issue. The DOL final regulations amending the FLSA can be found at the DOL's Web site:

<http://www.dol.gov/esa/regs/fedreg/final/2004009016.htm> .

⇒ A PowerPoint presentation prepared by the DOL that is helpful in clarifying which employees are considered exempt under the new regulations because they fall into the categories of Executive, Administrative and Professional, is part of the packet of materials for this Webinar.

In Determining Which Employees Are Exempt, **First Ask** Whether the Position in question meets the **Threshold Salary Basis Test**:

Exempt Employees Must Receive at Least \$455 Weekly on a Salary Basis

The new regulations establish a threshold of \$455 a week for exempt employees. If an employee does not earn at least \$455 in a week, s/he will NOT qualify as an exempt employee. If the employee does not meet the threshold, the employee MUST be paid hourly and must be classified as a non-exempt employee.

Employees must also be paid on a salary basis in order to be exempt

Being paid on a "Salary Basis" means that:

- The employee regularly receives a predetermined amount of compensation each pay period (on a weekly or less frequent basis) that is at least \$455 weekly
- The compensation is never reduced because of variations in the quality or quantity of the work performed
- The employee is always paid the full salary for any week in which the employee performs *any* work (but compensation need not be paid for any workweek when no work is performed.)

Secondly, the Position's Job Duties Must **Fall Into One of the Exempt Categories**:

There are quite a few different categories of potentially exempt workers, but generally only three categories are relevant for nonprofit organizations. These three categories are: Executive, Administrative and Professional (which includes teachers and academic administrative personnel in elementary and secondary schools).

These definitions come from the Regulations and are set forth in more detail on the PowerPoint presentation provided with the Webinar materials:

- ❖ **Executive:** (i) primary duty is “management of the enterprise;” (ii) customarily and regularly directs the work of two or more other employees; and (iii) authority to hire or fire other employees⁴ or whose suggestions and recommendations as to hiring, firing, advancement, promotion or other change of status of other employees are given particular weight.
 - ⇒ Examples of “management” include: interviewing, selecting, and training employees; setting and adjusting pay and work hours; appraising employee productivity and efficiency; handling employee complaints and grievances; disciplining employees; planning and apportioning work among employees; planning and controlling the budget
- ❖ **Administrative:** (i) primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer; and (ii) includes the exercise of discretion and independent judgment with respect to matters of significance.⁵
 - ⇒ Note: Discretion and independent judgment *does not* include: (i) applying well-established techniques, procedures or specific standards described in manuals or other sources; (ii) clerical or secretarial work; (iii) recording or tabulating data or performing mechanical, repetitive, recurrent or routine work, such as data entry.
- ❖ **Professional:** primary duty must be the performance of work requiring advanced knowledge in a field of science or learning that is customarily acquired by a prolonged course of specialized intellectual instruction
 - ⇒ Requires MORE than high school level education; specialized academic training is a prerequisite for being considered a “professional”; best evidence that an employee meets this requirement is possession of the appropriate academic degree. Teachers with degrees or certifications are exempt; teachers’ aides are not.

⁴ The exempt executive need not have authority to make the ultimate decision, which may rest with the Board.

⁵ Factors include, but are not limited to:

- Whether the employee has authority to formulate, affect, interpret, or implement management policies or operating practices
- Whether the employee carries out major assignments in conducting the operations of the business
- Whether the employee performs work that affects business operations to a substantial degree, even if the employee’s assignments are related to operation of a particular segment of the business

Other exempt categories:

Creative artists, dancers, actors, journalists, and specialized information technology professionals.

Highly Compensated Employees Are Exempt when:

- Total annual compensation is at least \$100,000
- At least \$455 per week paid on a salary or fee basis
- Perform office or non-manual work
- Customarily and regularly perform any one or more of the exempt duties identified in the standard tests for the executive, administrative or professional exemptions

A Word about Independent Contractors

Nonprofits that use several independent contractors or consultants need to be sure that the independent workers truly are independent workers rather than employees in the eyes of the DOL. If the DOL classifies them as employees, then the nonprofit will be responsible for back overtime, if applicable, as well as back tax withholdings for employer and employee contributions, as well as potential penalties. Mis-classifying employees as independent contractors is one of the most common mistakes that result in a nonprofit's liability for DOL penalties. Generally employees work under the control and supervision of the nonprofit while an independent contractor or consultant is not subject to the same degree of control. The IRS has developed a 20-factor test that it uses to investigate contractor status. Different states may weigh some of the factors differently, but in general the 20-factor test is a good starting point to review whether the workers that your nonprofit treats as independent contractors are properly classified. The 20-factor test is included in the Webinar materials.

What are the Risks for Violation of the FLSA or State Wage and Hour Laws?

\$\$\$: Back wages and back income tax withholdings: When a violation of wage and hour laws occurs it is often because the employer did not classify a worker correctly, resulting in underpayment of wages, and underpayment of corollary employer and employee contributions that are generally withheld from wages (example: failure to contribute state unemployment and temporary disability insurance, and failure to contribution or withhold social security at the federal level). Consequently, often when an employer has to settle a score with the DOL, there is a large and unexpected bill to pay to the government.

Penalties: There are generally also penalties to pay for violation of the state or federal laws. Penalties for violations of the FLSA include criminal prosecution for willful violations, carrying fines up to \$10,000. A subsequent conviction can result in imprisonment. Employers who willfully or repeatedly violate the minimum wage or overtime pay requirements are subject to civil money penalties of up to \$1,000 per violation. Violations of state law will carry separate

penalties. If the violation is not willful, the employer should try to negotiate with the state or federal DOL to eliminate or substantially reduce the employer's liability for penalties.

⇒ Note that insurance will not cover penalties for violation of laws.

Danger Zone! *Don't Treat an Exempt Employee Like a Non-Exempt Employee*

It invites trouble to misclassify employees or to classify them one way but treat them inconsistently with their classification. Consequently, it can be risky to treat exempt workers as if they were non-exempt (hourly) by requiring them to fill out time sheets that track their hours of work⁶ or by docking their pay in ways that the DOL considers to be inconsistent with exempt worker treatment.

Loss of Exemption through Improper "Docking"

No exempt employee may be "docked" less than a full day's compensation. Generally exempt employees' pay should not be docked at all, with seven specific exceptions:

The seven exceptions from the "no pay-docking" rule are:

1. Absence from work for one or more full days for personal reasons, other than sickness or disability
2. Absence from work for one or more full days due to sickness or disability if deductions are made under a bona fide plan, policy or practice of providing wage replacement benefits for these types of absences
3. To offset any amounts received as payment for jury fees, witness fees, or military pay.
4. Penalties imposed in good faith for violating safety rules of "major significance"
5. Unpaid disciplinary suspension of one or more full days imposed in good faith for violations of workplace conduct rules
6. Proportionate part of an employee's full salary may be paid for time actually worked in the first and last weeks of employment
7. Unpaid leave taken pursuant to the Family and Medical Leave Act

Improper deductions include:

- Deduction for a partial-day absence to attend a parent-teacher conference
- Deduction of a day of pay because the employer was closed due to inclement weather
- Deduction of three days of pay because the employee was absent from work for jury duty, rather than merely offsetting any amount received as payment for the jury duty

⁶ Some grants require nonprofits to maintain time sheets to keep track of staff hours dedicated to a specific grant-funded project. Such time sheets are different than daily time sheets used for employees to submit for payroll purposes.

- Deduction for a two day absence due to a minor illness when the employer does not provide wage replacement benefits for such absences
 - NOTE: The practice of making improper deductions from salary will result in the loss of the exemption for the entire time period during which the improper deductions were made, and for all employees in the same job classifications or who are working for the same managers responsible for the actual improper deductions. Isolated or inadvertent improper deductions, however, will not result in the loss of exempt status *if the employer reimburses the employee.*

How might a violation of FLSA or State Wage and Hour regulations come to light?

1. The most common way that a wage and hour violation is disclosed is when a disgruntled employee or former employee contacts the DOL and files a complaint, which is not hard to do. Employees can find out how to file a complaint from local [Wage and Hour Division offices](#), or from the DOL's toll-free help line at 1-866-4USWAGE.
 - Note that it generally will be a separate violation of law to retaliate against an employee who files a complaint or who participates in an investigation concerning claimed violations of either the FLSA or state wage and hour laws.
2. Other tip offs: The DOL might get a call from an employee with a question or a complaint and decide to conduct an audit of the organization.
3. The DOL might target the organization as part of a planned review of different types of nonprofit organizations, which are common targets of DOL audits in this area.
4. The DOL might show up unannounced at the workplace to conduct a random audit.

In addition to penalties, under the FLSA an employee may file a civil suit, generally for the previous two years of back pay (three years in the case of a willful violation) and an equal amount as liquidated damages, plus attorney's fees and court costs.

Summing Up

The suggestions offered here remind you about basic risk management principles to guide your organization as it evaluates risk in the area of classifying employees. The section below suggests principles and practices for your organization to follow to reduce risk and offers a “self-check” that will uncover whether there are any significant risks. If so, the Center strongly recommends that your organization enlist the assistance of an employment lawyer for further advice.

Basic Risk Management Principles and Practices to Reduce Liability For Incorrectly Classifying Workers

- ❖ Regularly review job descriptions to identify whether each position is exempt or non-exempt and review the work performed by independent contractors and consultants to make sure that they are properly classified.
- ❖ Clearly communicate the expectation that all exempt employees work as many hours as needed to accomplish their performance goals and are not entitled to “overtime,” and that non-exempt employees are required to have prior authorization before they work in excess of their regularly scheduled work week.
- ❖ If your workplace grants flexibility to employees in connection with their work hours, remember that treating similarly situated employees inequitably is asking for trouble.
- ❖ Have a clearly communicated complaint mechanism for employees to use if they believe there is improper wage treatment so that the organization will have the opportunity to address concerns before the employee takes those concerns to the DOL or a lawyer.
- ❖ Regularly review payroll against time sheets and ensure that there are no abuses or inappropriate deductions from wages. If so, promptly reimburse employees for any improper deductions; and once an inappropriate classification or wage issue comes to light, make a good faith commitment to promptly correct it and to comply consistently with the laws in the future.
- ❖ When in doubt, classify a worker as non-exempt. Since the greatest risk is in failing to pay overtime compensation, if you classify a worker as non-exempt and keep track of the worker’s hours, your organization should be able to manage its liability for overtime compensation and there won’t be any surprises.
- ❖ Require all overtime to be authorized in advance. Non-exempt employees must be paid for every hour worked. Budgets need to be met, and consequently, it should not be left to an employee’s discretion how many hours s/he will work and be paid for. Employees should be required to get authorization in advance from their supervisor before they work additional hours.

How Can I Protect My Nonprofit from Liability? In addition to the principles and practices listed above, use this checklist to determine whether there are any significant risks that require further consideration at your organization:

- Identify and document on the job description which positions are exempt from overtime.** This will require taking a close look at every job description for every position and ensuring that the job description and compensation for those positions that you have identified as “exempt” truly do meet the requirements of exemption. Make sure that the weekly compensation is \$455+ and that the employee is paid on a salary basis; then compare the job duties to the descriptions of either “executive” “administrative” or “professional” in the Webinar materials.
- Consult with legal counsel, experienced in employment matters if you are not positive that a particular position meets the requirements of exemption.** Don’t wait until the DOL audits your organization to find out that certain employees should have received overtime payments!
- Review personnel policies and practices with supervisors to confirm that non-exempt workers are paid for all time worked and that overtime is being documented and properly paid.** All supervisors need to be on the same page about authorization for employees to work flexible hours—consistency across the workforce is a key risk management practice. If need be, revise the organization’s written policies to clarify work hours, flex time and overtime practices.
- Review each relationship with outside workers whom the nonprofit organization considers to be independent contractors or consultants to verify that the outside workers will not be considered to be employees by the DOL.** There should be written agreements with each outside worker that spell out the independent nature of their service to the nonprofit. Compare the actual work habits of the outside workers with the 20-Factors that the IRS uses to define independent contractors. Do your outside workers seem more like employees? If so, it is less risky to treat them as employees, than as independent contractors.

Finally: Recognize that insurance will not cover penalties for violations of the FLSA or state wage and hour regulations, or the back pay owed to an employee for overtime worked.

The presenter and moderator for this Web Seminar welcome your comments and questions about the topics covered in this program or other employment-related concerns affecting your nonprofit. The presenters can be reached by email as follows:

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Resources:

- Society for Human Resource Management
1800 Duke Street
Alexandria, VA 22314
Phone: (800) 283-SHRM
TTY/TDD: (703) 548-6999
Fax: (703) 535-6490
Web site: www.shrm.org
- Department of Labor, Wage and Hour
Compliance Assistance Website: <http://www.dol.gov/esa/whd/flsa/>
Employer Guide to Minimum Wage and Overtime Pay:
<http://www.dol.gov/compliance/guide/minwage.htm>
- Workforce Management
Crain Communications, Inc.
4 Executive Circle, Suite 185
Irvine, CA 92614
Phone: (949) 255-5340
Fax: (949) 221-8964
Web site: www.workforce.com
- Employment Law Information Network
The Innovation Center @ Wilkes-Barre
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Web site: www.elinfonet.com