MANAGEMENT employee benefit plans



Overtime Pay Requirements for Salaried Employees

By Janet A. Meade

usiness owners might be surprised to learn that their biggest liability could be their workforce. About 115 million employees, or 86% of the workforce, are covered by federal overtime rules, according to the U.S. Department of Labor (DOL). Increasingly, these workers are bringing suit against their current or former employers for violations of the wageand-hour rules of the Fair Labor Standards Act (FLSA). Targets of the lawsuits aren't just employers of hourly workers. Classaction complaints are currently pending against BDO Seidman, PricewaterhouseCoopers, Sun Microsystems, Intel, Disney, J.P. Morgan Chase, and scores of other employers of skilled, salaried

employees. Given this litigious landscape, it is imperative for CPAs to understand the overtime rules so that they can avoid potentially devastating damages.

Discerning which employees are exempt from overtime pay requires more effort than just figuring out who is salaried. An employer must also consider an employee's education, responsibility, and decision-making authority. Classifying an employee incorrectly can be costly. Under the FLSA liquidated damages provision, court awards can be as much as twice the overtime pay adjustment. These awards, when combined with attorney fees and litigation expenses, can make the total cost of an FLSA violation staggering.

According to the DOL's Wage and Hour Division, more than \$185 million in back wages and almost \$10 million in civil penalties were recovered from 28,242 compliance actions in 2008 alone. Even settling out of court can be costly, as evidenced by KPMG's recent \$10 million settlement for unpaid overtime involving its unlicensed Canadian employees.

Which Employees Are Exempt?

The FLSA requires overtime to be paid to most employees at the rate of one and one-half times their regular rate of pay when working more than 40 hours in a week. Simple as that may sound, the Wage and Hour Division estimates that up to 70% of employers may be in violation of this rule. The most common violation concerns incorrect classification of an employee as being exempt from overtime pay. The FLSA provides an exemption from overtime pay for those working as executive, administrative, professional, and computer employees when they are paid a salary not less than \$455 per week, or for computer employees compensated on an hourly basis, at a rate not less than \$27.63 an hour. Other exemptions apply to outside sales employees and highly compensated employees. In order for an exemption to apply, however, an employee's specific job duties and compensation must meet all the requirements of the FLSA regulations (detailed in the Sidebar).

The rapid rise in class actions against employers for violations of the wage-and-hour rules dates back to 2004, when the DOL revised the FLSA regulations to clarify which employees were exempt from overtime laws. The revised exemptions, however, continue to cling to the act's Depression-era mentality rather than recognizing the realities of today's 24/7 business environment. Many employees working in this environment now fall into what might be described as a gray zone in that their jobs don't fit neatly into one of the exempt categories.

Consider, for example, the learned professional exemption. This exemption requires an employee's primary duties to be the performance of work requiring advanced knowledge in a field of science or learning and customarily acquired by a prolonged course of specialized intellectual instruction. Traditionally, this exemp-

tion has covered professionals working in the fields of law, medicine, accounting, actuarial computation, engineering, architecture, and similar occupations. Class actions currently pending in California against BDO Seidman and PricewaterhouseCoopers, however, claim that firstand second-year accountants working as associates as they train to take the CPA exam are rank-and-file employees eligible for overtime pay. The lawsuits argue that most of the work performed by associates during the first two years of employment is menial and does not require independent discretion or judgment as stipulated by law. Instead, the lawsuits contend that accountants must be licensed to be properly classified as exempt.

Walt Disney's Internet Group is facing a similar suit related to misclassification. Financial analysts for the company assert that their jobs are nonexempt because their duties, which include checking cost metrics data for errors and paying invoices, are routine and repetitive and do not require consistent exercise of discretion and judgment. Hedge fund accountants at J.P. Morgan Chase similarly claim that they were wrongly classified as exempt and denied overtime pay.

Explanations for the rise in overtime lawsuits involving salaried employees go beyond problems with the FLSA exemptions. Facing a labor squeeze, many supervisors try to boost productivity in order to look good. This often translates into violations of company wage-and-hour policies at lower and middle levels if a supervisor adopts a "don't ask, don't tell" attitude. Alternatively, some employers try to escape the overtime rules by giving their salaried employees titles that suggest managerial discretion when in fact the employee has none. But job titles mean little when it comes to determining whether an employee is properly classified. What matters instead is the employee's job description and the actual tasks performed.

Another problem can arise when employers try to accommodate employees by giving them flexible working hours or compensatory time for extra hours of work. Unless the employer is a public agency, these accommodations are not allowed as a substitute for overtime pay. Similarly, most bonuses and other incentive payments cannot be treated as part of

any employee's overtime pay unless they are tied to each hour worked.

Equally important in explaining the flurry of lawsuits is the change in employee mindset. Today's younger, more transient workforce often feels little loyalty to any one employer. Wired into this mindset is a strong belief in work-life balance and an assertiveness in protecting their rights. Through the Internet and text messages, they are better connected with others outside the workplace and quicker to seek change. When these employees are confronted with an increasingly demanding work environment, illdefined FLSA regulations, and an abundance of employment law attorneys mining for class-action plaintiffs, the resulting litigation seems almost inevitable.

Damage Awards

When the DOL brings a compliance action against an employer, the resulting damage award often can be staggering. This is partly because the FLSA calculation of overtime pay owed to a salaried employee incorrectly classified as exempt tends to overstate an employee's hourly pay rate. In calculating an hourly employee's pay rate, the total remuneration received is divided by the total number of hours worked. For example, an hourly employee earning \$900 in a 60-hour week is considered to earn \$15 per hour. The employer consequently would owe \$7.50 per hour for the additional 20 hours of work each week, or a total overtime premium of \$7,800 for the year ($\7.50×20 hours $\times 52$ weeks). If the same employee were classified as exempt and paid a salary of \$900 per week without regard to the number of hours worked, then the DOL would presume that the \$900 payment covers only the first 40 hours of work. The employee's hourly rate, therefore, would be calculated as \$22.50 (\$900 ÷ 40 hours), with overtime pay of \$33.75 $($22.50 \times 1.5)$ due on each of the additional 20 hours. This calculation would result in a total of \$35,100 in overtime pay owed for the year ($$33.75 \times 20 \text{ hours} \times 52 \text{ weeks}$). Had the salaried employee received any nondiscretionary bonuses, educational incentive payments, or other premiums, the hourly rate would be increased accordingly, resulting in an even greater liability for unpaid overtime. The receipt of stock options or stock appreciation rights, however, would not increase the hourly rate.

The "look back" period for assessing damages generally is two years before a complaint is filed and continues until the case is resolved. An additional year's recovery period is permitted if the violation is willful in that the employer knew that its employment and pay practices violated the FLSA, but it "disregarded" these obligations. Violations normally result

in an award for liquidated damages equal to twice the balance of overtime pay due, with half of the award essentially in lieu of interest on the unpaid wages. The employer of an individual working an unspecified number of hours in return for a salary of \$900 per week therefore might be assessed liquidated damages of $$140,400 ($35,100 \times 2 \times 2 \text{ years})$$ if the

employee actually worked 60 hours each week over a two-year period, with no bonuses or other premium payments. Had that same employee been paid wages of \$900 for a 60-hour work week, the liquidated damages would have been only $$31,200 ($7,800 \times 2 \times 2 \text{ years})$.

In addition to liquidated damages, an employer found in violation of the FLSA

DETERMINING WHO IS EXEMPT

Executive Exemption:

- The employee must be compensated on a salary basis at a rate not less than \$455 per week;
- The employee's primary duty must be managing the enterprise or managing a customarily recognized department or subdivision of the enterprise;
- The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
- The employee must have the authority to hire or fire other employees, or the employee's suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

Administrative Exemption:

- The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers; and
- The employee's primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

Learned Professional Exemption:

- The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;
- The advanced knowledge must be in a field of science or learning; and
- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

Creative Professional Exemption:

■ The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;

■ The employee's primary duty must be the performance of work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.

Computer Employee Exemption:

- The employee must be compensated either on a salary or fee basis at a rate not less than \$455 per week or, if compensated on an hourly basis, at a rate not less than \$27.63 an hour;
- The employee must be employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field performing the duties described below;
- The employee's primary duty must consist of: 1) the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications; 2) the design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications; 3) the design, documentation, testing, creation, or modification of computer programs related to machine operating systems; or 4) a combination of the aforementioned duties, the performance of which requires the same level of skills.

Outside Sales Exemption:

- The employee's primary duty must be making sales or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- The employee must be customarily and regularly engaged away from the employer's place or places of business.

Highly Compensated Employee Exemption:

- The employee must perform office or nonmanual work and be paid total annual compensation of \$100,000 or more (which must include at least \$455 per week paid on a salary or fee basis); and
- The employee must customarily and regularly perform at least one of the duties of an exempt executive, administrative, or professional employee.

Source: Section 13(1)(1) of the Fair Labor Standards Act as defined by federal regulations, 29 CFR Part 541.

is required to reimburse the wronged employee for litigation expenses and reasonable attorney fees. Civil penalties of up to \$1,000 per violation also may be assessed on repeated or willful violations. As a consequence, even a minor infraction can result in a substantial liability.

Collective or Class Action?

Another reason violations of the wageand-hours rules can be extremely costly for employers is the rise in FLSA collective actions. Unlike traditional class actions, FLSA collective actions allow current and former employees who are similarly situated to opt-in to an action through written consent. The opt in provision differs from the traditional class action's opt-out provision in that it does not require plaintiff employees to prove participation numbers, common issues, typical job functions, or adequacy of representation. Instead, they need only prove that they have similar legal issues in similar factual settings. The FLSA opt-in provision makes it relatively easy for large numbers of current and former employees to join an action because the same policy or practice that results in one employee being underpaid or incorrectly classified as exempt will likely involve many other similar employees. Differences in work schedules, compensation, and working hours generally won't exclude employees who are otherwise similar to those participating in the action.

State Laws

Many state laws provide benefits that are greater than those available under the FLSA. Most states, for example, impose minimum wage rates that are higher than the federal rates, and many require overtime pay for certain employees who are otherwise exempt under the FLSA. Alaska, California, and Nevada require overtime pay after eight hours of work in a day or 40 hours in a week, unless an alternative flexible work plan that meets certain formalities has been adopted. Colorado imposes a similar requirement, except the daily limit is 12 hours. Damage awards in some states also are more favorable. Massachusetts, for example, recently changed its wage-and-hour laws to require employers to pay triple damages for any violation, while in Maine employees can claim six years of back wages and overtime payments. Compliance with the FLSA, therefore, is no guarantee that an employer's pay practices conform to state requirements.

Alternatives to Overtime Pay

Several alternatives to overtime pay exist. First, it may be possible for an employer to rearrange an employee's schedule to ensure that no more than 40 hours are worked in a single week. For example, an employee who works four 10-hour days followed by three days off is not required to be paid for overtime in most states. Rearranging an employee's schedule, however, is not an option in those states that impose a daily overtime standard.

Another option for employees whose jobs require them to work varying hours from week to week is for the employer to adopt a compensation arrangement known as a Belo plan. Under the plan, which takes its name from a 1942 Supreme Court decision in Walling v. A.H. Belo Corporation (316 U.S. 624), an employee whose job necessitates irregular hours, such as a news reporter, outside service technician, or insurance adjuster, is compensated at a predetermined fixed weekly salary at least equal to the minimum wage rate for the first 40 hours and one and one-half times that rate for a maximum number of hours over 40. The maximum number of hours to be worked without additional compensation must be determined by mutual agreement between the employer and employee, but it is limited by the FLSA to no more than 60. Variations in work must result in weeks having hours both below and above 40 so that the weekly guarantee bears a reasonable relationship to the average hours worked. In addition, the employer must maintain accurate records of time worked, and overtime must be paid when an employee exceeds the maximum number of hours specified in the agreement.

A similar, but more flexible, compensation arrangement for salaried employees whose weekly hours of work vary is for the employer and employee to reach an advance understanding that the employee will receive a fixed amount as straight pay for whatever hours are worked in a week, with any hours over 40 paid as an overtime premium of one-half the hourly rate. Under this so-called fluctuating work-

week method, the regular hourly rate varies from week to week and is determined by dividing the employee's salary by the total number of hours worked in the week. An overtime premium is then paid in addition to the salary, calculated by multiplying the hours in excess of 40 by one-half of the regular rate for that week.

Neither the FSLA regulations nor the case law establish a requirement as to the degree of fluctuation in hours that must occur, nor do they require that the employee work both long and short workweeks. But they do require that the salary be sufficient to provide compensation to the employee that is not less than the minimum wage rate for every hour worked and to ensure that the agreed-upon salary is paid even when the workweek is less than a full schedule of hours. Employers who adopt this pay method generally do so to reduce their financial exposure should an exempt employee's job classification later be challenged, but the pay method also can serve as a tool for enhancing employee relations by rewarding employees for extra work.

Limiting Liability

The best way for an employer to limit its potential liability under the FLSA is to take preemptive action to ensure compliance with the law. Employers should review the classifications of all exempt and nonexempt employees. Classifications should not be based on job titles, but on the actual duties performed by an employee. Job descriptions also should be reviewed and updated to include accurate descriptions of the work performed. Other preemptive actions include examining pay practices and educating supervisory and human resources personnel about the overtime rules and the type of work that is exempt. Employers may also want to develop written workplace compliance rules and conduct periodic assessments of compliance efforts. Lastly, some employers may find it necessary to adjust compensation, hire additional employees, or utilize temporary workers.

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