

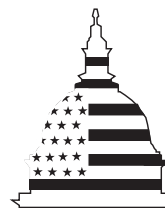
GAO

Report to the Subcommittee on
Workforce Protections, Committee on
Education and the Workforce, U.S.
House of Representatives

September 1999

FAIR LABOR STANDARDS ACT

White-Collar Exemptions in the Modern Work Place



G A O

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**Health, Education, and
Human Services Division**

B-283016

September 30, 1999

The Honorable Cass Ballenger
Chairman
The Honorable Major R. Owens
Ranking Minority Member
Subcommittee on Workforce Protections
Committee on Education and the Workforce
House of Representatives

The Honorable Bill Goodling
Chairman
The Honorable William Clay
Ranking Minority Member
Committee on Education and the Workforce
House of Representatives

After more than 60 years, the Fair Labor Standards Act (FLSA) remains the primary federal statute setting the minimum wage and hour standards applicable to most American workers. Since its enactment in 1938, the industrial profile of the American economy has shifted dramatically, changing from predominantly manufacturing to increasingly service-oriented. Critics of the FLSA claim that this shift, as well as the increased use of sophisticated technology, have left the FLSA and its regulations outdated and in need of revision.

One area of concern involves the so-called “white-collar” exemptions of the FLSA. The Act limits the normal work-week to 40 hours, requiring most employers to pay hourly overtime wages to employees who work longer than 40 hours. However, under section 13(a)(1) of the Act, employees working in a “bona fide executive, administrative, or professional capacity” are exempted from the wage and hour standards. These white-collar employees need not be paid overtime premium pay for a work-week longer than 40 hours.

Employers from both the private sector and state and local governments have focused their criticisms on Department of Labor (DOL) regulations that define the “exempt” white-collar employees. Under the FLSA, DOL is responsible for setting the criteria for these exemptions, and historically it has formulated specific regulatory tests based on the accumulated experience of employers, employees, and its own field staff with work-place issues. Currently, employees must meet each of three tests to

be classified as exempt white-collar workers: (1) the employee must be paid a salary, not an hourly wage (the salary-basis test); (2) the amount of the employee's salary must indicate managerial or professional status (the salary-level tests); and (3) the employee's job duties and responsibilities must involve managerial or professional skills (the duties tests).

In response to your request for information on employer compliance with the white-collar exemptions under the FLSA, this report focuses on five questions: (1) How many employees are covered by the white-collar exemptions and how have the demographic characteristics of these employees changed in recent years? (2) How have the statutory and regulatory requirements changed since the enactment of the FLSA? (3) What are the major concerns of employers regarding the white-collar exemptions? (4) What are the major concerns of employees regarding the white-collar exemptions? (5) What are possible solutions to the issues of concern raised by employers and employees? We performed our work in accordance with generally accepted governmental auditing standards from November 1998 through June 1999. Our scope and methodology are presented in appendix I.

Results in Brief

In 1998, between 20 and 27 percent of the full-time U. S. workforce—or 19 to 26 million workers—were executive, administrative, or professional employees covered by white-collar exemptions of the FLSA.¹ In recent years the percentage of employees covered by these exemptions has been increasing. The number of employees working in certain service industries² nearly doubled between 1983 and 1998, and there is a higher percentage of white-collar employees in the service sector than in other sectors of the economy, such as manufacturing. Overall, the workforce covered by the exemptions also became increasingly female—the proportion of women increased from 33 percent in 1983 to 42 percent in 1998. In addition, in 1998, workers subject to the white-collar exemptions were more than twice as likely as nonexempt workers to work overtime—44 percent of exempt employees worked more than 40 hours in a work-week, and about one-third of those worked more than 50 hours in a work-week.

¹Our estimate includes only those employees who would most likely be properly classified as exempt workers under the DOL regulations. It may not include all employees who are classified as exempt workers by their employers.

²These industries included four types of service occupations from the Current Population Survey (CPS) industry codes: business and repair, personal, entertainment and recreation, and professional and related services. For definitions of other industries discussed in this report, see app. I.

In the 16 years following the 1938 enactment of the FLSA, DOL established the key regulatory tests defining whether an employee can be classified as an exempt white-collar worker. These tests included the salary-basis test—the requirement that exempt white-collar workers be paid a salary, not an hourly wage—as well as the various salary-level and duties tests. Since 1954, major statutory and regulatory changes to the white-collar exemptions have been few, and primarily limited to increases in the salary-test levels and to changes to coverage of specific types of employees. In recent years, for example, the salary-basis test has been adjusted for state and local government employees, and higher-wage computer programmers were included in the exemption.

In general, employers we contacted were concerned that the regulatory tests were too complicated and outdated. Specifically, their concerns included the following:

- Employers worried about potential liability for violations of the salary-basis test. While DOL viewed the test as being a highly accurate indicator of managerial and professional status, in recent years it has been the focus of legal suits brought collectively by groups of managerial and professional employees against their employers. Our review of federal cases and discussions with employers showed continuing uncertainties and difficulties with the test.
- Employers also believed that the regulations limiting the exemptions to white-collar nonproduction employees did not take into account the effect of modern technology on employment. For example, they pointed to highly skilled and well-paid technicians who did not qualify as exempt professionals, but who performed essentially the same job as exempt engineers with the required academic degrees.
- Finally, employers complained that the parts of regulatory duties tests that call for independent judgment and discretion on the part of those classified as administrators and professionals led to confusing and inconsistent results in classifications of similarly situated employees. Our discussions with DOL investigators and review of compliance cases indicated that this part of the duties test involved difficult and sometimes subjective determinations, and that it was a source of contention in DOL audits.

Employee representatives, on the other hand, were most concerned about preserving work-hour limitations for employees, and believed that the regulatory tests, as applied today, were not sufficient to adequately restrict

the use of the exemptions by employers. Specifically, they cited the following concerns:

- Employee representatives believed that inflation has severely eroded the salary-level limitations originally envisioned by the DOL regulations. The regulations create three levels of regulatory duties tests, depending on employees' salaries. Under the regulations, the lower the employee's salary, the greater the limitations on the use of the exemptions. However, the regulations do not provide for automatic or periodic adjustments of the salary levels, and the levels have not been changed since 1975. To fully account for inflation between 1975 and 1988, the salary levels would have to be increased about threefold. As a result of the increase in salaries over that period, almost all full-time employees in 1998 were covered by the least-restrictive regulatory duties test—leaving more people than ever who potentially fall under the white-collar exemptions.
- The representatives contended that the duties test for executive employees has been oversimplified, leading to inadequate protection of low-income supervisory employees. Our review of federal case law and DOL compliance cases indicated that it is, in fact, difficult to challenge exempt classifications if employees supervise two or more full-time employees and spend some time—even if minimal—on management tasks.

Although various proposals have been advanced to address the concerns raised in this report, the conflicting interests of employers and employees have made resolution difficult. Some proposals would, for example, eliminate the salary-basis test or raise the salary-test levels. However, for every proposal—even those with consensus, such as increasing the salary-test levels—there are competing interests to be considered. To resolve these issues, the desire of employers for clear and unambiguous regulatory standards must be balanced with that of employees for fair and equitable treatment in the work place. Although DOL established the regulatory tests by balancing these competing interests, these same interests have made DOL reluctant to alter the current regulatory structure. In the last 45 years, DOL has adjusted the FLSA regulations only in a piecemeal fashion to meet the needs of particular types of employers and employees. Given the economic and work place changes over this period, a more comprehensive look at these regulations is necessary to determine whether a consensus could be achieved on how to amend the regulations to better suit the modern work place. This report recommends that the Secretary of Labor comprehensively review current regulations and restructure white-collar exemptions to better accommodate today's work place and to anticipate future work place trends.

Background

The FLSA sets the minimum wage most employers must pay their employees and the maximum hours—40 per week—most employees can work without receiving extra, overtime premium pay (at time-and-one-half the regular rate). In addition, the FLSA specifies which workers are exempt from these requirements. Although numerous categories of workers are exempt from these requirements,³ the largest group of exempt workers includes employees classified as executives, administrators, or professionals under section 13(a)(1) of the Act. These are sometimes called the white-collar exemptions, although not all white-collar employees are exempt.

The FLSA was enacted to address problems associated with substandard working conditions by establishing a floor on wages and a ceiling on hours, beyond which the employer was required to pay extra wages. The purpose of the overtime provision was to shorten the work-week to a more reasonable 40 hours. This was expected to result in less employee fatigue, fewer accidents, higher productivity and efficiency, and more employee time for education and family duties. By requiring overtime premium pay, it was expected that employers would hire more workers to avoid the extra wage costs, and that workers would be assured additional pay to compensate them for the burden of a work-week in excess of 40 hours. The Minimum Wage Study Commission of 1981⁴ justified the exemption of executives, administrators, and professionals from the protections of the FLSA in part because these employees were associated with higher base pay, higher promotion potential, and greater job security, making them different from other employees. Moreover, the nature of their jobs—managerial and professional—precluded the potential for the job expansion desired in other types of employment (that is, hiring more workers to perform the additional hours of work).

For employers and employees, the practical consequences of the exempt worker classification can be very important. An exempt employee may be required to work as many hours as it takes to complete a task. Although this may be more than 40 hours per week, the employee will not be entitled to overtime premium pay for the hours exceeding 40. Thus, an exempt financial manager may be required to work 60 hours a week and be paid a set weekly salary. On the other hand, a nonexempt bookkeeper

³Currently, section 13(a) lists 10 other categories of workers (in addition to managers and professionals) as exempt from both the minimum wage and maximum hours provisions of the FLSA. These include diverse groups of employees, such as babysitters and those working at recreational establishments.

⁴The legislative history for the FLSA contains no explanation for the exemption.

may also be required to work 60 hours per week, but must be paid at a premium hourly wage for 20 hours (the number exceeding 40 per week) in addition to a set weekly salary.⁵

Ever since the FLSA was enacted, the interests of employers in expanding the white-collar exemptions as broadly as possible have competed with those of employees in limiting use of the exemptions. In 1940, for example, DOL reported that groups representing employers argued for broader use of the exemptions to allow management training, to increase flexibility in work-hour scheduling, and to ensure a stable weekly pay for employees. At the same time, employee representatives argued against broader use of the exemptions, trying to reduce the potential for abuse and exploitation of workers.

Balancing the competing interests of employers and employees, DOL established specific regulatory tests that must be met before an employee can be classified as an exempt white-collar⁶ worker. In general, there are three major parts to these tests:

- First, the employee must be paid on a salary basis, not at an hourly rate. This means that the employee must be paid a guaranteed amount each pay period, independent of the number of hours that the employee has actually worked and the quality and quantity of work performed.
- Second, the employee must be paid at least a specified base salary level that indicates managerial or professional status. DOL regulations include different salary levels. One is a base level for each type of exempt white-collar worker—executive, administrative, or professional—below which workers are assumed to be nonexempt and covered by the FLSA minimum wage and overtime requirements. The other is a higher salary level, above which employees will likely be exempt if their primary duties are managerial or professional.
- Third, the employee must have duties and responsibilities associated with managerial or professional work. Generally, such duties must include appropriate independent judgment and discretion. However, depending upon the employee's salary level—whether it is above or below the highest salary level—DOL regulations call for either closer scrutiny (with a long, detailed test) or not as much scrutiny (with a short, limited test) of the nature of the employee's duties.

⁵Salaried workers may be either exempt or nonexempt; being paid a salary is not determinative of exempt status.

⁶DOL does not refer to a white-collar exemption; the exemption is referred to routinely as covering executive, administrative, and professional employees.

The regulatory tests vary among the three categories of employees—executive, administrative, and professional. Table 1 summarizes the major tests required for each type of exemption. For each category of employee, we identify the salary levels included in the regulations and the associated duties test. We refer to the lower salary as the base salary, and the applicable duties test as the long test. The higher salary level is referred to as the upset test, and the applicable duties test as the short test.

Table 1: Summary of Current Regulatory Tests for Executive, Administrative, and Professional FLSA Exemptions

Employee type	Paid a salary	Base salary (triggers long duties test)	Long duties test	Upset salary (triggers short duties test)	Short duties test
Executive	Yes	\$155 per week	Various indicators, including a primary duties test and a requirement that no more than 20 percent of work (or 40 percent if in retail or service) involve nonmanagerial work	\$250 per week	(1) Must supervise two or more employees, and (2) primary duty must be management
Administrative	Yes; also may be paid on a fee basis	\$155 per week	Primary duties test including the percentage limitations on nonexempt work, plus other indicators of administrative responsibilities	\$250 per week	(1) Primary duty must involve office or nonmanual (or staff) work directly related to management, and (2) work must require discretion and independent judgment
Professional	Yes; also may be paid on a fee basis	\$170 per week	Primary duties test including the percentage limitations on nonexempt work, plus other indicators of professional responsibilities	\$250 per week	Either (1) must have requisite academic degree and job must require consistent exercise of discretion and independent judgment, or (2) must involve original and creative work requiring invention, imagination, or talent in recognized field

Source: GAO analysis of DOL regulations.

Number of White-Collar Exemptions Increases With Growth of Service Sector

We estimate that between 19 and 26 million full-time wage and salary workers⁷ were covered by the white-collar exemptions in 1998.^{8,9} This amounts to 20 to 27 percent of the full-time labor force. Based on the high estimate of 26 million, our estimate represents an increase of 9 million workers over our 1983 estimate of 17 million exempt full-time wage and salary workers (see table 2). For a detailed description of the methods used to obtain these estimates, see appendix I.

Table 2: Estimates of Full-Time White-Collar Workers Exempt in 1983 and 1998

Year	Total full-time wage and salary workers (millions) ^a	Covered by white-collar exemptions			
		High estimate		Low estimate	
		Number of employees (millions)	Percentage of full-time wage and salary workers	Number of employees (millions)	Percentage of full-time wage and salary workers
1983	71	17	24%	12	17%
1998	96	26	27%	19	20%

Notes: Includes employees exempt under sec. 13(a)(1) of the FLSA. 29 C.F.R. 541 defines those employees classified as executive, administrative, professional, or outside sales workers. Outside sales workers are not included in this analysis. Please see app. I for a discussion of these estimates.

^aWage and salary employment numbers are from the CPS Outgoing Rotations Data analysis and match the Bureau of Labor Statistics (BLS)-published Employment and Earnings annual averages.

Source: CPS Outgoing Rotations Data for 1983 and 1998.

Much of the growth in exempt workers can be attributed to the growth in the service sector of the economy. In 1998, the service industries employed 24 million full-time workers—nearly doubling from 13 million workers in 1983. All sectors of the labor market saw some growth in the number of workers between 1983 and 1998;¹⁰ however, no other sector has

⁷Full-time wage and salary workers exclude self-employed workers and workers under age 16.

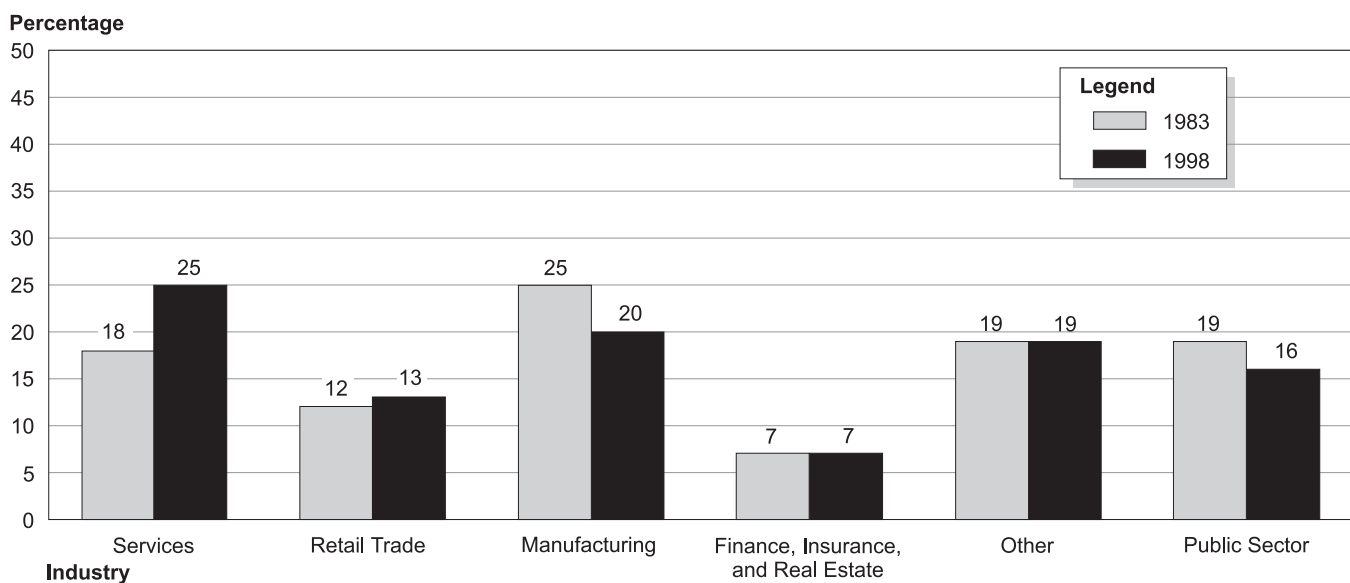
⁸For each of 257 job titles, DOL provided us with a range estimate—for example, 10-50 percent—of the employees in that job category who would probably be exempt. We arrived at our low estimate (19 million) by using the lower ends of DOL's individual job category range estimates, and at the high estimate (26 million) by using the upper ends of those individual estimates.

⁹Our work is not an attempt to count the actual number of people classified as exempt by American employers, but rather to estimate how many full-time workers are covered by the white-collar exemptions.

¹⁰The number of full-time wage and salary workers grew between 1983 and 1998 as follows: services, 13 to 24 million; retail trade, 8 to 13 million; manufacturing, 18 to 19 million; finance, insurance, and real estate, 5 to 7 million; other, 14 to 18 million; and public sector, 13 to 16 million.

grown as rapidly in the last 15 years. As figure 1 shows, in 1998 one-quarter of all full-time workers held jobs in the service sector, which makes it the largest employment sector.

Figure 1: Percentage of Full-Time Wage and Salary Workers in 1983 and 1998 by Industry



Notes: The sampling errors for the estimates in this figure do not exceed plus or minus 0.5 percentage points at the 95% significance level.

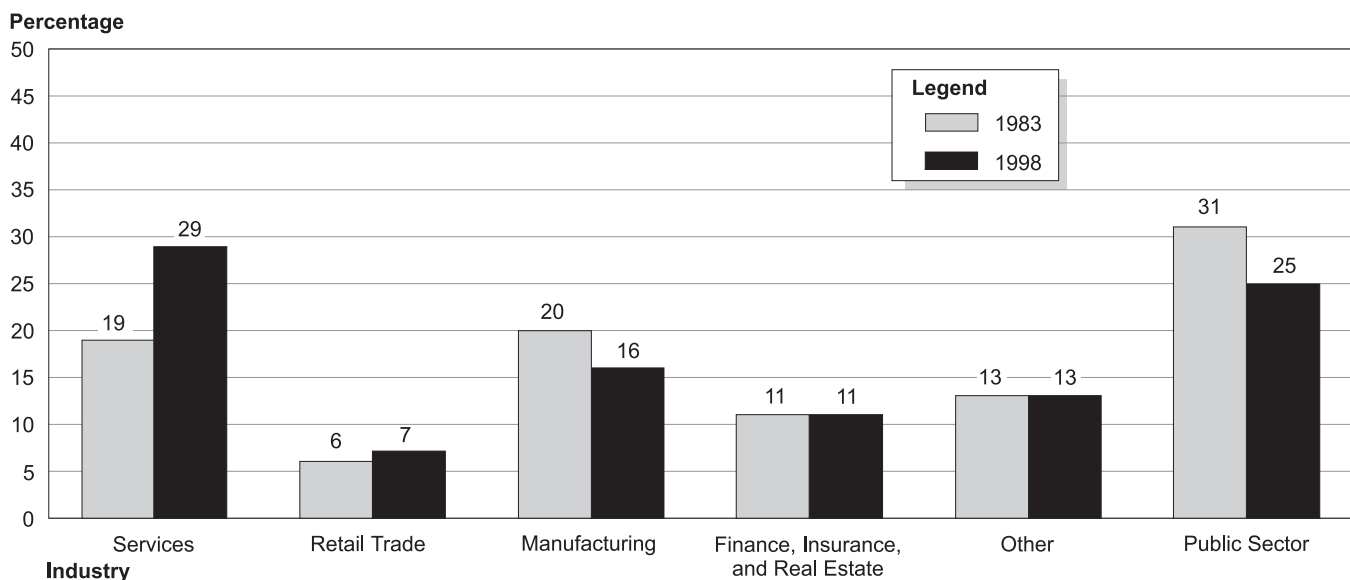
Service industries included four types of service occupations from the Current Population Survey (CPS) industry codes: business and repair, personal, entertainment and recreation, and professional and related services. For definitions of other industries discussed in this report, see app. I.

Source: CPS Outgoing Rotations Data for 1983 and 1998.

In addition to growing rapidly, the service sector also has a higher proportion of exempt workers than other sectors and is responsible for much of the growth in the exempt population. Not only has the service sector grown by 11 million full-time workers in the last 15 years, but the number of exempt workers in the service sector has increased by

3.6 million.¹¹ Over the last 15 years, the increase in the number of full-time workers covered by the white-collar exemptions has been about 8 million. The increase of 3.6 million exempt workers in the service sector over this same time represents about 46 percent of the overall growth in exempt workers. As a result of this rapid growth, 29 percent of all exempt workers worked in the service sector in 1998—up from 19 percent in 1983 (see figure 2).

Figure 2: Percentage of Full-Time White-Collar Workers Exempt in 1983 and 1998 by Industry



Notes: The percentage estimates represent the average of the high and low estimates. See app. I for a discussion of these estimates.

Service industries included four types of service occupations from the Current Population Survey (CPS) industry codes: business and repair, personal, entertainment and recreation, and professional and related services. For definitions of other industries discussed in this report, see app. I.

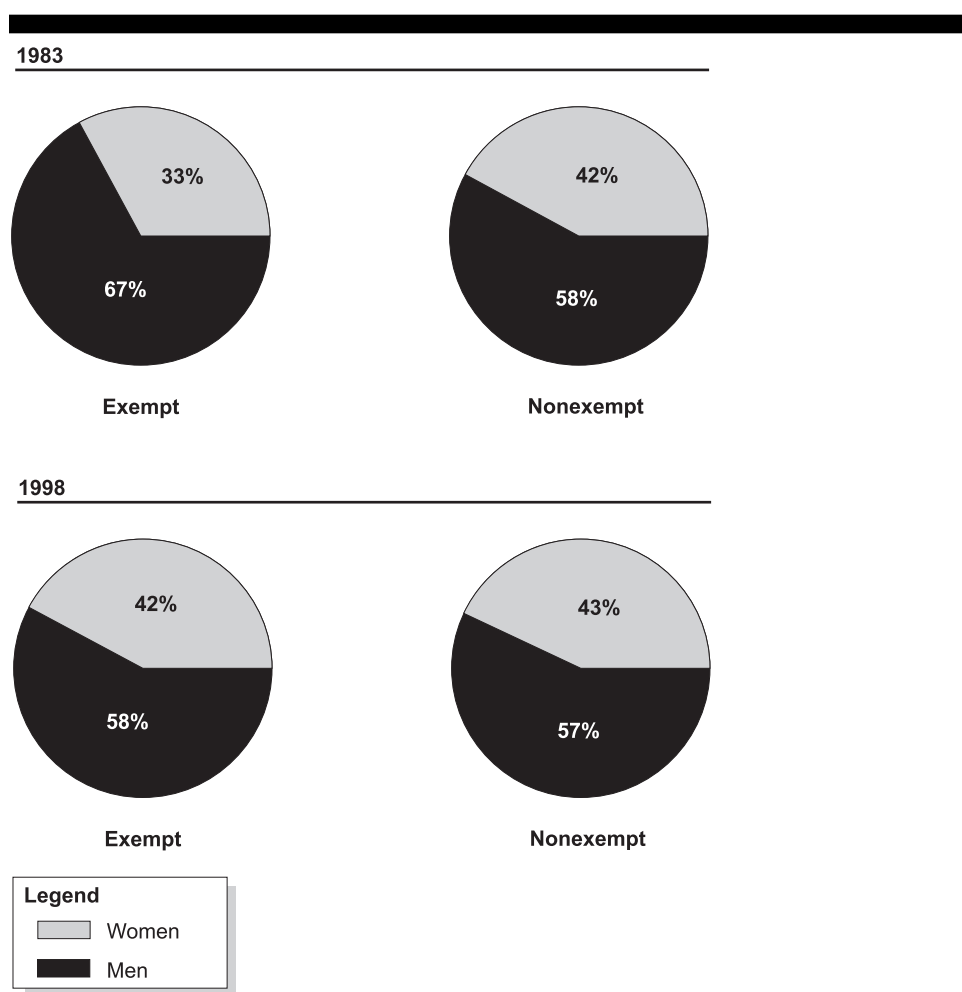
Source: CPS Outgoing Rotations Data for 1983 and 1998.

The demographic composition of the exempt population has significantly changed in the last 15 years. In 1998, 42 percent of exempt workers were

¹¹This estimate and those that follow represent the average of the high and low estimates. Please see app. I for a discussion of these estimates.

women, compared to 33 percent in 1983 (see figure 3). On the other hand, the gender distribution of nonexempt workers has not changed in the last 15 years. About 40 percent of nonexempt workers were women in both 1983 and in 1998. These data indicate that more women than men entered full-time white-collar positions over this period.

Figure 3: Percentage of Full-Time White-Collar Exempt and Nonexempt Workforce in 1983 and 1998 by Gender

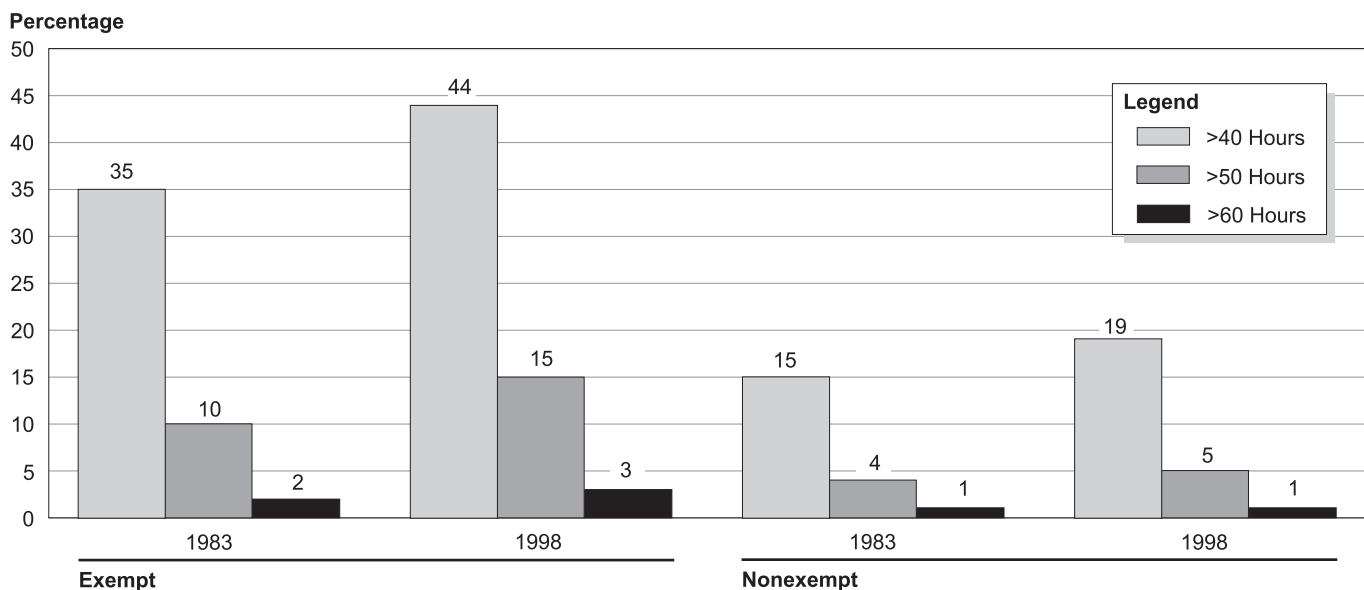


Note: The percentage estimates represent the average of the high and low estimates. See app. I for a discussion of these estimates.

Source: CPS Outgoing Rotations Data for 1983 and 1998.

Full-time workers covered by the white-collar exemptions are much more likely to work overtime—that is, more than 40 hours per week—than nonexempt workers (see figure 4). As figure 4 shows, in 1998, nearly half—44 percent—of the 19 to 26 million full-time workers covered by the exemptions said they worked overtime at their primary job. In 1983, about one-third—35 percent—of full-time exempt workers worked more than 40 hours per week. In fact, exempt workers were more than twice as likely to work overtime in both 1983 and 1998 as nonexempt workers. In general, the amount of overtime hours worked by both exempt and nonexempt workers was greater in 1998 than in 1983. In this regard, in 1998, about 15 percent of exempt workers worked more than 50 hours per week and 3 percent worked more than 60 hours per week at their main job. This compares to 10 percent working more than 50 hours per week and 2 percent working more than 60 hours in 1983.

Figure 4: Percentage of Full-Time Exempt and Nonexempt White-Collar Workers Who Worked Overtime in 1983 and 1998



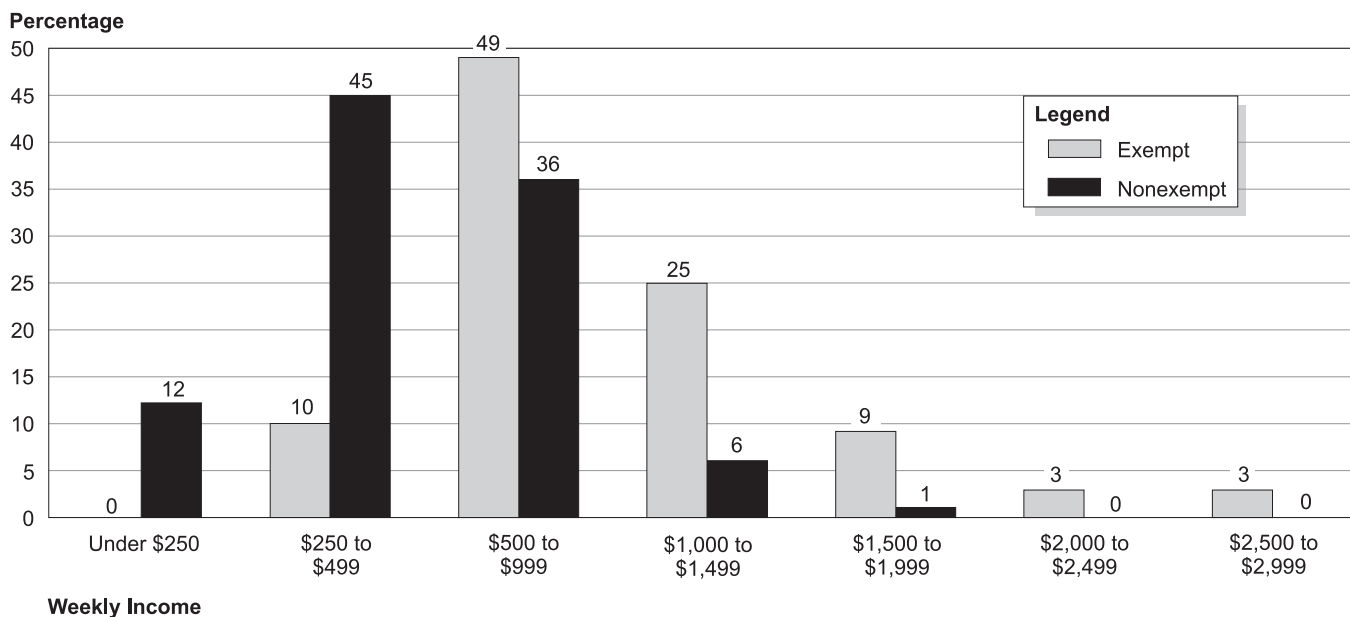
Note: The percentage estimates represent the average of the high and low estimates. See app. I for a discussion of these estimates.

Source: CPS Outgoing Rotations Data for 1983 and 1998.

As figures 5 and 6 show, exempt workers earned substantially more than nonexempt workers in 1998. In figure 5, 40 percent of exempt workers earned \$1,000 or more per week, compared to only 7 percent of nonexempt workers. Conversely, 57 percent of nonexempt workers earned less than \$500 per week, compared to only 10 percent of exempt workers.

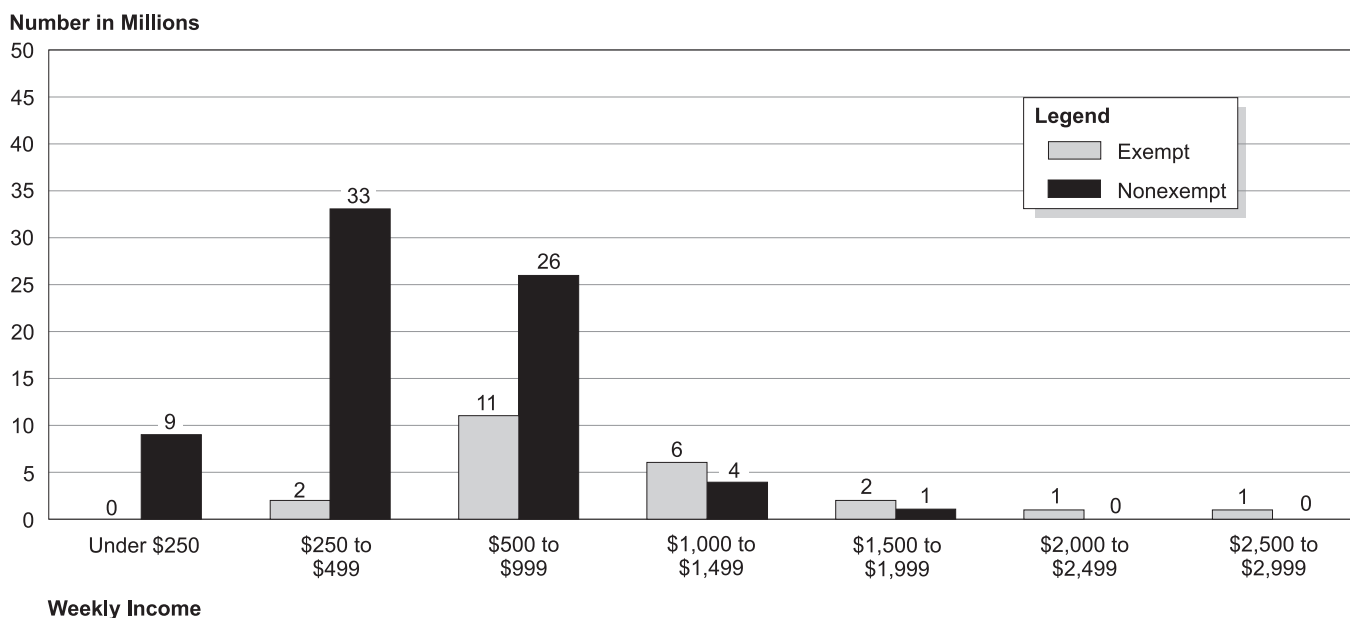
Figure 6 illustrates that there are many fewer exempt workers than nonexempt workers.

Figure 5: Percentage of Full-Time Exempt and Nonexempt White-Collar Workers in 1998 by Weekly Income



Note: The percentage estimates represent the average of the high and low estimates. See app. I for a discussion of these estimates. The zero percentages in this table are the result of rounding and represent a number between 0 and 0.5 percent.

Source: CPS Outgoing Rotations Data for 1998.

Figure 6: Number of Full-Time Exempt and Nonexempt White-Collar Workers in 1998 by Weekly Income (in Millions)

Note: The numerical estimates represent the average of the high and low estimates. See app. I for a discussion of these estimates. The zeros in this table are the result of rounding to the nearest million and represent a number between 0 and 500,000 people.

Source: CPS Outgoing Rotations Data for 1998.

In 1998, the average weekly earnings of full-time exempt workers were nearly twice those of nonexempt workers—\$1,018¹² weekly compared to \$526 for nonexempt workers. The difference in earnings between exempt and nonexempt workers was similar in 1983.

Few Major Changes in Exemption Laws and Regulations Since 1954

In the 61 years since the enactment of the FLSA, there have been few major changes to the statutory and regulatory provisions for the white-collar exemptions. Between 1938 and 1954, DOL established its basic set of regulatory tests—the salary-basis test, the salary-level tests, and the various duties tests. Although DOL made a public request for views on restructuring the regulations in 1985, it has not acted to alter the general

¹²The earnings figures reported here are earnings from the respondent's main job before taxes or other deductions including earnings from overtime pay, commissions, or tips from that job.

way the regulatory tests work since 1954. Changes after 1954 have primarily involved adjustments to the salary-test levels and to the tests applicable to specific types of workers, such as retail workers, state and local government employees, and computer programmers.

In the 16 years following the enactment of the FLSA in 1938, DOL established the regulatory tests used to determine whether an employee should be classified as an exempt white-collar worker. These tests evolved as DOL's experience with administering the tests grew. For example, the first set of regulations in 1938 included a single test for executives and administrators. Two years later, responding to numerous criticisms, DOL drafted two separate definitions—one for “executives,” to apply to people who are bosses, and another for “administrative” employees, to apply to people who carry out management policies but who do not supervise other employees. DOL made its final change to the structure of the basic tests in 1954, when it adjusted the exceptions to the salary-basis requirement.

Since 1954, statutory and regulatory revisions have, in general, either (1) adjusted the salary levels upward or (2) modified the coverage of the exemption, extending or reducing coverage for a particular type of worker. The salary levels were adjusted in 1958, 1963, 1970, and 1975. DOL last attempted to increase these levels in 1981; a Presidential order, however, indefinitely postponed these increases. In 1961, statutory and regulatory revisions eliminated a separate exemption covering most retail workers and specifically included these workers under the white-collar exemptions. Other statutory and regulatory changes expanded coverage of the exemptions to teachers (1967)¹³ and certain higher-wage computer professionals (1992). A regulatory revision in 1992 limited the effect of the salary-basis requirement for state and local governments.

All statutory and regulatory revisions on white-collar exemptions are presented in appendix II. The major changes are summarized in table 3.

¹³As pointed out in table 3, public educational institutions were not covered by the FLSA until 1967.

Table 3: Summary of Major Statutory and Regulatory Revisions to the White-Collar Exemptions

Year of revision	Summary of revision
1938 through 1954	Basic regulatory tests set forth in regulations
1961	Separate retail trade exemption repealed but retail employees were included, with a limitation, under the general coverage of the white-collar exemption
1967	FLSA was applied to public educational institutions but teachers and school administrators were included under the exemption
1973	The equal pay provision of the FLSA was made applicable to all those included under the white-collar exemption
1992	Under certain circumstances, state and local government workers were excepted from selected aspects of the salary-basis requirement Certain computer professionals earning over 6-1/2 times the minimum wage were exempted from the FLSA, even though they were paid an hourly wage

Source: GAO analysis of statutory and regulatory provisions.

Employers Believe the Regulatory Tests Are Too Complicated and Outdated for the Modern Work Place

From our reviews of 166 federal court cases¹⁴ involving litigation on this subject and 66 DOL compliance cases,¹⁵ as well as our discussions with employers, DOL officials, and various legal and economic experts, the following three issues stood out as being of particular concern to employers:

- First, the complex requirements of the salary-basis test or the so-called “no-docking” rule presented possibly the greatest potential liability for employers and made it difficult to account for employees’ time and actions.
- Second, the traditional limits of the white-collar exemptions between the highly paid, very skilled nonexempt technical workers and the exempt professional and administrative employees have been blurred in the modern work place.
- Third, the requirement for independent judgment and discretion on the part of administrative and professional employees was a major area of contention in DOL audits involving the white-collar exemptions.

¹⁴We reviewed 5 years of judicial opinions (1994 through 1998) for both federal district court and federal appellate court cases.

¹⁵We reviewed 66 compliance cases closed in the past 2 years in four DOL field offices.

Employers Cite Perceived Difficulties of Salary-Basis Test

The salary-basis test requires that exempt white-collar employees be paid a set salary each pay period, rather than an hourly wage. The test appears to rest upon the assumption that employers would pay managerial and professional employees who are key to their business operations a guaranteed salary regardless of the number of hours worked. In the DOL enforcement program, this test is viewed as an accurate indication of managerial and professional status. The test, however, effectively limits the ability of employers to “dock” exempt employees’ pay for such things as part-day personal absences and disciplinary violations (hence, the so-called no-docking rule). Employers object to the test because in their opinion (1) compliance requires exacting adherence to the no-docking requirements, leaving them vulnerable to private lawsuits by multiple, well-paid employees; and (2) it limits their ability to hold their exempt employees accountable for their time and actions.

In general, DOL regulations specify that employees can be exempt executives, administrators, and professionals only if they are paid on a salary basis—that is, employers must pay them a full salary for any week worked “without regard to the number of days or hours worked.” Although there are exceptions to this rule,¹⁶ a private employer¹⁷ may not dock an exempt employee’s pay for absences of less than a full day—for whatever reason—without violating the salary-basis test. In addition, neither public nor private employers can dock an exempt employee’s pay for periods of less than a week to enforce disciplinary rules except for a violation of a safety rule of major significance. Employers, therefore, must pay exempt employees a full weekly salary even though the employees may, for example, take time off during the day for an extended lunch or a visit to the dentist. Further, employers cannot suspend exempt employees without pay for less than 1 week for such things as tardiness or unexplained absenteeism.

In our interviews, employers and their representatives discussed the complex requirements of the salary-basis test, and their concerns that if they should not comply with the requirements, they may face lawsuits brought by multiple (and possibly highly paid) employees for back wages and other damages. Under the FLSA, employees may sue their employer either individually or collectively for up to 2, and in some cases 3, years of

¹⁶Exceptions to the rule include deductions of a day or more for personal reasons other than sickness and accident, deductions of a day or more for sickness if in accordance with company policy, and deductions for violation of safety rules of major significance.

¹⁷A 1992 amendment to the regulations allowed state and local governments to dock employees’ pay for part-day absences under certain circumstances.

back wages plus other damages. In our review of federal court cases, we found that the salary-basis test has been the central focus of cases brought by employees against their employers. Our review of 166 federal cases involving the white-collar exemptions litigated in the past 5 years showed that about 50 percent involved employee suits alleging that employers improperly claimed exemptions for employees who did not meet the salary-basis test.

For the most part, the salary-basis cases involved groups of supervisory or professional employees collectively suing their employers. However, the large majority of cases were initiated by groups of managerial public employees (such as police and fire chiefs, senior corrections officers) against state and local governments,¹⁸ most often because the government could suspend or had suspended the pay of exempt employees as a penalty for disciplinary infractions. Overall, over 70 percent of the salary-basis cases were collective actions, and about 70 percent were lawsuits against state and local governments.

A 1997 Supreme Court case, Auer v. Robbins, reduced employers' potential for liability from these lawsuits.¹⁹ In this case, a large group of senior police officers sued a city government because its disciplinary suspensions appeared to apply to exempt officers even though the city had only suspended one police sergeant. The court ruled in favor of the city, and effectively limited employers' liability for improper pay docking to cases where there is an "actual practice" or a "significant likelihood" of such action. Prior to this decision, some federal cases had ruled that an employer did not meet the salary-basis test if there were only a possibility that the employer might improperly dock an exempt employee's pay. The result of this ruling is that fewer cases have resulted in liability for employers—our review of 42 federal cases following Auer showed that 30 were decided in favor of the employers. However, the full effect of the Auer ruling has yet to be determined.

Our discussions with employers and review of other federal cases showed a variety of circumstances in which employers were uncertain about the

¹⁸In a recent decision, Alden v. Maine, 119 S.Ct. 2240 (1999), the Supreme Court ruled that state employees cannot sue a state in state courts for overtime wages under the FLSA if the state has not waived its sovereign immunity. A previous Supreme Court decision, Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996), precluded such suits in federal courts.

¹⁹519 U.S. 452.

limits of the test. Some examples²⁰ of questions concerning these circumstances include the following:

- What constitutes an “actual practice” of pay docking? When does one instance connote an actual practice?
- When can employers correct instances of improper pay docking and not incur liability?
- What happens when an employee has no accrued leave? Can an employer deduct from accrued compensatory time?
- The Family and Medical Leave Act requires employers to give employees unpaid leave for serious medical conditions; if such leave is taken in partial-day increments, does it violate the salary-basis test?
- Under what circumstances can employers pay hourly overtime to exempt workers and maintain time sheets or set work hours?
- Can an employee be disciplined for failure to complete a work shift?
- An employer cannot suspend an exempt employee for less than a week; if the suspension is for more than a week, must the employer suspend the employee only in weekly increments?

In *Auer*, the Supreme Court expressly deferred to the Secretary of Labor as the expert on regulatory interpretation of the salary-basis test. According to legal experts we talked to, clear guidance to employers from DOL on the technical requirements of the test may resolve some uncertainties. However, they indicated that it can be difficult for the public to locate published legal advice from DOL. As one solution, they suggested that DOL make its “opinion letters”—legal guidance it routinely provides to individual employers—more widely available to the general public, for example, by putting them on the Internet.

However, even where the requirements of the salary-basis test were relatively clear, employers argued that the effects on their operations created anomalies. In the retail industry, for example, employers cannot dock an exempt employee’s pay to recoup losses from cash shortages or employee theft. If they do so, the employee is considered nonexempt and entitled to overtime wages. Employers complained that this rule unduly limits their ability to recover losses where responsibility clearly rests with one employee, such as when an employee delivering cash receipts to a bank loses the cash or an employee uses a corporate credit card for personal items.

²⁰In commenting on this report, DOL stated that it believes some of the legal issues raised by employers have been authoritatively addressed in either the case law or the law itself. Our review of the case law indicates that legal conclusions on issues related to the salary-basis test can vary depending upon the factual circumstances of individual cases.

Officials from three large local governments²¹ told us that the salary-basis test made it difficult to penalize employees with systematic disciplinary steps. All three local governments are heavily unionized and to satisfy the union contracts they must use “progressive discipline.” This means that before harsh disciplinary actions—such as long-term suspensions or termination—can be used to discipline an employee, less severe disciplinary measures—such as part-day suspensions without pay—must be taken to alert the employee to performance problems. However, the officials contend that the salary-basis test prevented them from taking such lesser measures.

DOL officials told us that they believe that payment on a salary basis remains one of the best indicators of managerial and professional status. This belief is longstanding. As a 1940 DOL report explained:

... The term “executive” implies a certain prestige, status, and importance. Employees who qualify under the definition are denied the protection of the act. It must be assumed that they enjoy compensatory privileges and this presumption will clearly fail if they are not paid a salary substantially higher than the wages guaranteed as a mere minimum under section 6 of the act. In no other way can there be assurance that section 13 (a) (1) will not invite evasion of section 6 and section 7 for large numbers of workers to whom the wage-and-hour provisions should apply. Indeed, if an employer states that a particular employee is of sufficient importance to his firm to be classified as an “executive” employee and thereby exempt from the protection of the act, the best single test of the employer’s good faith in attributing importance to the employee’s services is the amount he pays for them. The reasonableness and soundness of this conclusion is sustained by the record.

A 1949 DOL report rejected proposals to eliminate the salary-basis test, commenting that “[C]ompensation on a salary basis appears to have been almost universally recognized as the only method of payment consistent with the status of the ‘bona fide’ executive . . . [and] is one of the recognized attributes of administrative and professional employment.” These principles were again reaffirmed in the report and recommendations of a 1958 hearing report on proposed revisions to the regulations.

Compliance investigators in DOL’s Wage and Hour Division said that the salary-basis test is a key enforcement test. Investigators told us that the

²¹Because it is clear that local governments (and other employers) violate the salary-basis test when they discipline their management officials by suspensions without pay, all three local governments we talked to have made large groups of their employees nonexempt rather than give up their disciplinary systems. One now pays its senior police officials overtime, another has limited its exempt workers to those paid over \$73,000 per year, and the third has made nearly all union workers nonexempt (90 percent of its employees are unionized).

first review they routinely undertake involves determining whether the exempt employees are paid on a salary basis. However, as one investigator explained to us, testing for compliance can be difficult because most often exempt employees have worked in excess of 40 hours and have been paid for at least 40 hours, making it hard to prove that employers have made improper deductions to the salaries of exempt workers. Although we found that the salary-basis test was not the central issue in most compliance cases we reviewed, it was critical to some cases. In one case, for example, a gas service station owner paid managers and assistant managers a salary of \$400 per week and required them to work 60 hours per week. Although the owner claimed the employees to be exempt executives, the investigator successfully challenged their executive status because the owner reduced their pay if they worked less than 60 hours per week.

Employers Say Some Production Workers Are Equivalent to White-Collar Employees

Nonsupervisory employees may be exempt from the FLSA if they can be classified as either administrative or professional employees. However, the administrative exemption is limited to those employees who perform nonmanual (or nonproduction) work “directly related to the management policies or general business operations” using independent judgment and discretion, and the professional exemption is generally limited to occupations requiring advanced academic degrees.²² Thus, as interpreted for the past 60 years, these exemptions do not apply to many technical workers—nonsupervisory line workers who work to produce the employer’s goods and who do not have the requisite academic degree for a recognized profession in which they are employed.

In our discussions with employers and state and local government representatives, both groups argued that the traditional limits of the white-collar exemptions are outdated in the modern work place. They believed that certain highly skilled, well-paid line workers should be treated as exempt workers because they have the knowledge equivalent to an exempt professional. Officials from manufacturing employers pointed to new technology used in factory work places, which they said required advanced technical skills but required far less traditional “manual” labor. Moreover, they told us that while these workers may have to follow precise written guidelines to perform their work, prescribed procedures were key to modern quality control. State and local representatives pointed to job classifications within their organizations which involved

²²There are, however, exceptions for certain specific occupations such as computer programming, based on a 1990 congressional enactment, and work of an artistic nature.

line work but which required the knowledge and experience of a civil service professional.

To illustrate the point, one company official described the job of technicians who maintain unmanned factories around the country. In her company, one technician, relying upon standardized instruments, monitors each automated factory. The official compared the nonexempt line jobs of these well-paid (about \$70,000 per year) technicians with those of her company's engineers. Both groups held similar jobs and earned comparable pay, but because the engineers had professional degrees and the technicians did not, only the engineers could be classified as exempt professional employees.

In general, employers pointed to the differences between exempt and nonexempt employee status as creating difficulties in managing the workforce, particularly in what they referred to as crossover positions like the technicians described above. According to the employers, nonexempt employees have less flexibility in work shifts—any work over 40 hours must be paid at overtime rates, even if the employee is planning on working less than 40 hours in the next work-week. Further, employers claim that workers look on exempt status as prestigious, allowing greater possibility of management promotion. In addition, employers also believed that adherence to strict written guidelines—one major distinction between exempt and nonexempt workers—is necessary in a modern, efficient work place.

In recent years, the distinctions between production and nonproduction workers, and between professional and technical production workers, have been increasingly blurred. The federal court cases and DOL compliance cases we reviewed provided illustrations of recent distinctions made between exempt and nonexempt nonsupervisory workers. These cases included the following:

- A large publishing firm employed about 50 production editors, each of whom managed the final publication processing of the company's books. One of these production editors sued the company, claiming that she was improperly classified as an exempt employee. A federal appellate court ruled that, although her job involved production work, she was an exempt employee. It found that her work was a major assignment of the company and, therefore, that it was directly related to the management policies or business operations of the company.²³

²³Shaw v. Prentice Hall Computer Publishing, Inc., 151 F.3d 640 (7th Cir. 1998).

- An insurance company employed automobile damage appraisers to determine the amount to be paid on auto insurance claims. A federal district court found the appraisers to be nonexempt production workers because they did not do work related to the management policies or business operations of the firm. Rather than administratively running the business, they carried out the daily affairs of the company.²⁴
- A title insurance company used escrow closers to conduct final property settlements. A federal district court held that these were nonexempt employees who were carrying out the day-to-day operations of the company²⁵ and that it was irrelevant that they were not part of the company's production department.
- One southern state's Department of Agriculture employed dairy inspectors and food safety inspectors. The dairy inspectors had academic training and experience in the specific area of dairy or animal sciences, while the food safety inspectors had more generalized academic training in biological sciences. DOL compliance review determined that only the dairy inspectors met the educational requirement of the professional exemption.

The Requirement for Independent Judgment and Discretion Is Difficult to Apply

To be classified as either an exempt administrative or professional employee, each employee must exercise independent judgment and discretion in carrying out his or her job duties. In general, the requirement for exercising independent judgment and discretion means that employees have the freedom to make choices about matters of significance to their employers, without immediate supervision or detailed guidelines. Factors which are taken into account include (1) the amount of supervision, (2) the amount of written guidelines, and (3) whether the work involves routine matters. For example, a newly hired accountant may be given work that is closely supervised, involving rote work with set procedures. In that case, the accountant would be nonexempt, even though he or she may have full professional certification.

Our discussions with employers and DOL investigators indicated that this aspect of the regulations is particularly difficult to apply for both the employers and the investigators. Employers complained that the standards for the independent judgment requirement were confusing and applied in an inconsistent manner by DOL. Thus, employers were unsure of how to properly classify administrative personnel. According to DOL investigators, determinations about independent judgment and discretion can be the most difficult part of a compliance review. To assess this requirement, an

²⁴Reich v. American International Adjustment Co., Inc., 902 F. Supp. 321 (D. Conn. 1994).

²⁵Reich v. Chicago Title Insurance Co., 853 F. Supp. 1325 (D. Kan. 1994).

investigator must review both the general duties of the position and the specific duties of the employee. Further, the determination may hinge upon how an individual employee views his or her own duties. For instance, one administrative assistant may look at his job as answering telephone calls and following orders, while another person in the same position might describe the job as involving the independence to establish office procedures and respond to incoming client inquiries.

The compliance cases we reviewed included a number of instances where the standard for independent judgment and discretion was key to determining the employee's status. Situations where this question arose included the following:

- A trucking company employed dispatchers to organize and schedule truck routes. Two of the dispatchers negotiated with other companies to obtain contracts for truck loads, as well as scheduling truck routes. The DOL compliance investigator allowed the administrative exemption for the two senior dispatchers, but not for the other dispatchers.
- A firm provided library services to professional firms. Firm officials claimed that certain librarians were exempt as either administrative or professional employees. The DOL investigator disagreed, finding the librarians were nonexempt because their work—filing and updating loose-leaf volumes—was “routine and not dependent on a professional degree.”
- An architectural firm hired professional architects and engineers. The firm classified its employees according to experience, but considered them all exempt. The DOL investigator found that architects and engineers at the entry level were nonexempt, because they did not exercise discretion and independent judgment in their jobs.

In our review, we noted certain cases in which an employer conducted its own self-audit and used this to negotiate a final settlement with DOL. One large accounting firm agreed to conduct a self-audit of all of its entry-level tax reporting accountants, and DOL agreed to not question the application of the professional exemptions to second- and third-year accountants. In another example, DOL investigators found certain job titles at a commercial bank that appeared to involve nonexempt work. To settle the compliance questions, the bank hired a law firm to conduct an audit of individual employee classifications. The lawyers examined the bank's FLSA classifications and recommended that changes be made. With the approval of DOL, the bank accepted the reclassifications suggested by the audit and agreed to pay the necessary back wages.

Employees Say That Inflation and Oversimplification Have Undermined Exemption Limits

Employee representatives and other experts were particularly concerned that the use of the exemptions be limited, maintaining the 40-hour work-week standard for as many employees as possible. To do this, they were of the opinion that the regulatory tests should provide the type of protection originally intended. In this regard, the following two issues seemed particularly important to employees:

- The salary-test levels that underpin the regulatory framework have been unchanged since 1975. Because of inflation, the current salary-test levels are now near the minimum-wage level, rendering the application of certain regulatory tests to the current workforce virtually meaningless.
- The duties test that determines who can be classified as an exempt executive has been increasingly simplified by judicial opinions. When combined with the low salary-test levels, employees believe that few protections remain for lower-income supervisors.

Inflation Has Effectively Eliminated Important Aspects of the Regulatory Tests

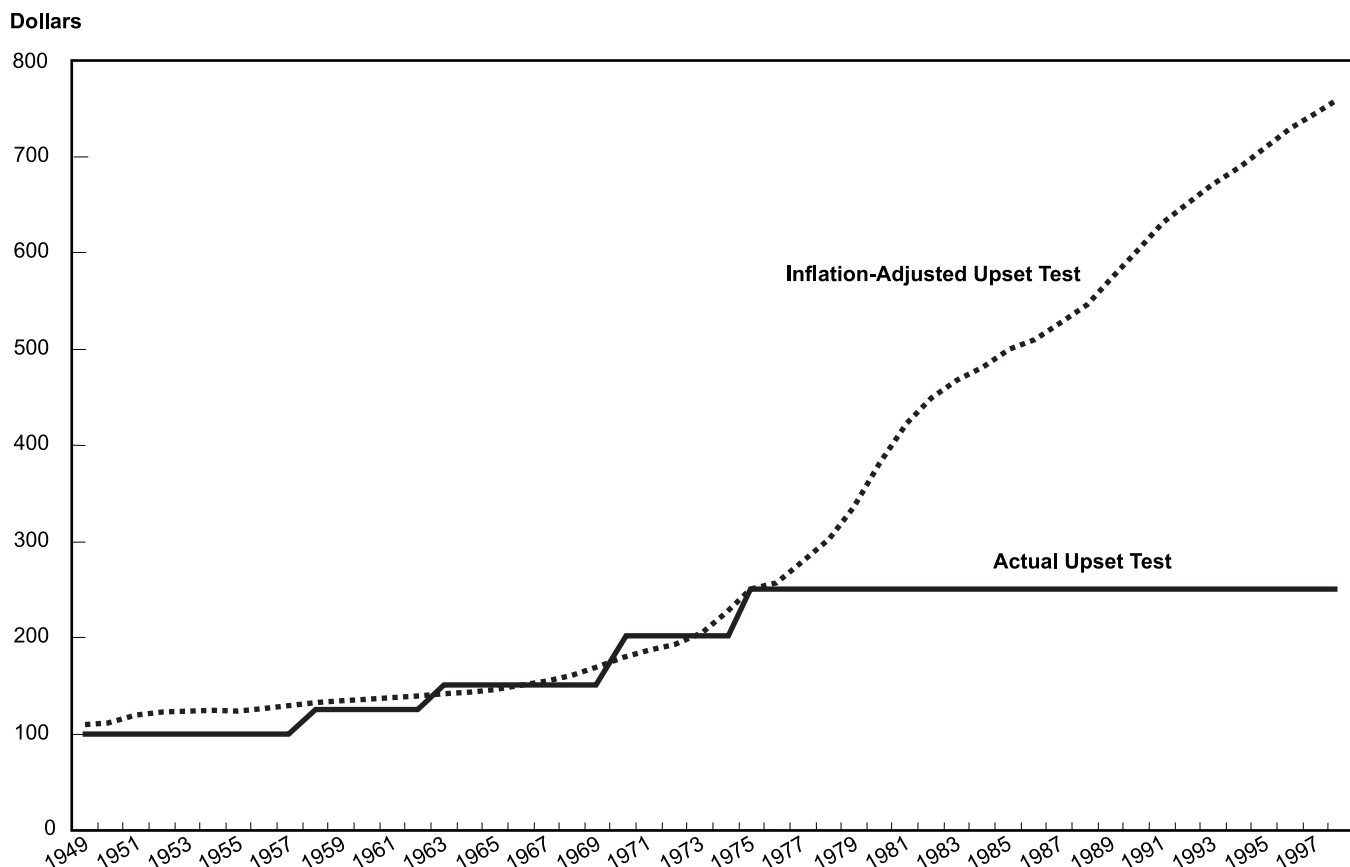
In determining whether an employee is exempt from the FLSA as an executive, administrator, or professional, the first consideration is the employee's salary. Since 1949, employees have been divided into three groups according to their weekly earnings. As described earlier in table 2, the standards vary depending on whether an employee is to be classified as an executive, administrator, or professional. For the executive exemption, the three groups currently are as follows:

- Employees earning less than \$155 per week are automatically nonexempt (or subject to the FLSA requirements).
- Employees making at least \$155 but less than \$250 per week are nonexempt unless their duties meet the rigorous standards of the so-called long duties test. The long duties test for executives requires that employees' duties include such things as the authority to hire or fire other employees and the ability to exercise discretion; most significantly, though, it sets percentage limitations on the amount of nonmanagerial work an exempt employee can perform in a work-week. Specifically, employees qualify as exempt employees only if no more than 20 percent (or less than 40 percent for retail and service employees) of their jobs involve nonmanagerial or nonprofessional work.
- Employees earning at least \$250 per week are exempt as long as their duties meet the less strict standards of the so-called short duties test, an abbreviated version of the long duties test. The short duties test does not specify percentage limitations on the amount of nonmanagerial work an exempt employee can perform. For executives, the test is limited to

requiring that employees supervise two or more workers and that their primary duty is managerial.

The practical differences between the long and short duties tests are significant. To illustrate, consider a cook who supervises a crew of other workers. If the cook's salary was \$200 per week, and he was thus subject to the long duties test, he would be nonexempt (and entitled to overtime wages) if he spent more than 40 percent of his time on nonmanagerial tasks—work such as cooking food or cleaning the kitchen. If, however, the cook's salary was \$250 per week, the cook would be an exempt executive as long as his primary duty was management and included the customary and regular direction of at least two other employees, even though he may spend a lot of time cooking food or cleaning the kitchen.

The salary levels used to determine into which of the three salary categories an employee falls have not been changed since 1975. During that time period, salaries in the nation have risen considerably. As a result, the salary levels used by DOL for this purpose, which in 1975 were considered fairly high, are now below the level of the federal minimum wage in the instances of the base salary levels. Even the higher level, \$250 per week, is equivalent to an hourly wage that is only \$1.10 per hour higher than the current minimum federal hourly wage of \$5.15 for a 40-hour work-week. For the salary levels used in this determination to represent the same level of purchasing power now as they did in 1975, they would need to be considerably higher than their current levels. For example, the highest of levels, \$250 per week, would have to be \$757 per week, for an annual salary of about \$39,400. In figure 7, we examine the highest salary level over the 49-year period between 1949 and 1998, and we compare the actual level included in the regulations with the level necessary to keep pace with inflation.

Figure 7: Actual and Inflation-Adjusted Highest Salary Test, or Upset Test, for Weekly Income, 1949-1998

Note: Upset test numbers are adjusted for inflation using the Consumer Price Index for all Urban Consumers (CPI-U), with 1975 as the base year.

Source: Data for the actual upset test are from 29 C.F.R. chap. V, part 541; inflation-adjusted upset test calculated by GAO.

To see the effect of inflation on the application of the regulatory tests, consider again the example of the supervisory cook. Today, the cook would be automatically nonexempt only if his salary was less than \$8,060 per year—the equivalent of \$3.88 per hour, \$1.27 less than the current federal minimum wage. The strict long duties test would apply only if he made less than \$13,000 (equivalent to an hourly rate not much higher than

the minimum wage for a 40-hour work-week). And, as long as he made \$13,000, he would be presumed to be an executive if his primary duty was management—for example, if he can hire and fire workers.

However, if the cook's salary was adjusted to include the inflation occurring between 1975 and 1998, the application of the regulatory tests would be very different. Using salary figures adjusted for inflation, the cook would be automatically nonexempt as long as he earned less than \$24,400. If he earned between about \$24,400 and \$39,400, he would be exempt only if his work met the long duties test. And, if he earned more than \$39,400, he would be an exempt executive if his primary duty were management.

Because of inflation, the percentage of full-time workers who potentially fell into each of the three salary level categories was far different in 1975 than in 1998²⁶—specifically,

- In 1975, about 30 percent of the full-time workforce would have been automatically nonexempt workers; in 1998, only 1 percent of the full-time workforce were automatically nonexempt.²⁷
- In 1975, about 30 percent of the full-time workforce would have been nonexempt unless they met the percentage limitation on performing nonexempt work; in 1998, the long duties test would apply to only 8 percent of the full-time workforce.
- In 1975, about 40 percent of the full-time workers could have qualified as exempt workers with the application of the short duties test; in 1998, 91 percent of the workers were under the short duties test.

Employees Say That Duties Test Offers Little Protection for Lower-Income Supervisors

During the past 20 years, it has become increasingly easy to classify a supervisory employee as an exempt executive. If an employee makes over \$250 per week (\$13,000 per year), the employee may be an exempt executive if he or she meets two criteria. First, the employee must customarily and regularly direct the work of two or more employees; and second, the employee's primary duty must involve management. Unlike the administrative and professional exemptions, there is no express

²⁶The data we used for these estimates include full-time wage workers as well as full-time salaried workers age 16 years and over. The data were provided by BLS and are unpublished tabulations from the CPS. The data for 1998 are annual averages while the data for 1975 are for the month of May, when annual averages were not available. Self-employed workers are excluded.

²⁷These percentages are approximate; the CPS data provide the percentage of workers who earn under \$150 per week, rather than under \$155 per week, the base salary for exempt executive and administrative employees.

requirement for independent judgment and discretion. However, the regulations specify that, “as a rule of thumb,” an employee who spends more than 50 percent of his or her time on management tasks would have management as a primary duty.

Two federal court decisions in 1982 clarified the test for determining whether an employee earning over \$250 per week has management as a primary duty. The cases, involving litigation between DOL and the Burger King Corporation,²⁸ applied the executive exemption to assistant managers at the fast-food restaurants. First, one decision held that the duties of Burger King assistant managers were primarily managerial, even though the company provided them detailed instructions on how they were to perform their work. Second, both courts found that the 50-percent “rule of thumb” limitation on nonmanagerial work was only one factor to consider when determining employees’ primary duty, and that their managerial duties could be carried out at the same time they were performing manual work. Thus, assistant managers could be exempt executives even if they spent most of the day cooking hamburgers—as long as they were in charge of the restaurants during their shifts.

While employers appreciate the simplicity and the clarity of the executive duties test, union representatives complained that the judicial rulings following the Burger King decisions have oversimplified the executive test. Under the regulations, as currently interpreted, almost any employee who is assigned to supervise two or more employees in a particular “department” of the company can be classified as an exempt employee. According to the union officials, employers have adjusted their work places to include many new levels of supervision in order to create exempt executive positions. Thus, where a grocery store originally had one or two store managers, it now has many different departments—the meat department, the produce department, and others—headed by exempt executives.

Federal case law in the 5-year period from 1994 through 1998 included hardly any instances in which a court overturned an employer’s classification of a lower-income supervisor as an exempt executive. In the 32 cases we identified as relating to the executive exemption duties test, about one-third (12 cases) involved employees whose salaries were \$500 per week (or \$26,000 per year) or less. Of these 12 cases, only 1 resulted in

²⁸Donovan v. Burger King Corp., 672 F.2d 221 (1st Cir. 1982), and Donovan v. Burger King Corp., 675 F.2d 516 (2d Cir. 1982).

a favorable ruling for the employee. These cases included a wide range of employees, such as:

- an aquatics director of a community swimming pool paid \$376 per week,
- a produce department manager of a grocery store paid \$450 per week,
- a dietary manager of a nursing home paid \$341 per week, and
- a loss-prevention manager of a department store paid \$423 per week.

All of these employees claimed that their jobs consisted primarily of nonmanagerial work—for example, life guarding, stocking shelves, and cooking. Despite evidence of large proportions of nonmanagerial work, the courts found all but one employee to be exempt executives.

Discussions with DOL investigators and attorneys suggested that the Burger King decisions and the low salary-test levels have had a major effect on their investigation of cases involving exempt executives. Since the decisions, their policy manual has been revised to require that investigators consider percentage limitations as only one factor when assessing the employee's primary duty. One attorney noted that in recent years little litigation had been initiated by DOL over the executive status of supervisory employees. He indicated that, although there may be situations in which the exempt executive classification of an employee supervising two or more workers could be challenged, those situations are very limited.

Conflicting Interests of Employers and Employees Make Resolution of Concerns Difficult

Legal and economic experts have proposed various ways to deal with the concerns raised by employers and employees, ranging from tinkering with particular provisions of the regulations to a major overhaul of the FLSA. However, proposals to change the present law or regulations all affect the regulatory balance between the desires of employers and those of employees, and there are competing interests that must be carefully weighed before any changes can be made. For a number of years, DOL has been reluctant to alter the existing tests in view of these competing interests. To illustrate some of these considerations, we discuss four proposals that have been made by experts to revise the current regulations, and summarize the general views of employers and employees on each.

Eliminate the Salary-Basis Test

From the employer's point of view, the salary-basis test presents complex regulatory requirements—for example, the limitations on the use of pay

suspensions to sanction employees' actions—that have nothing to do with managerial or professional status but that can be the source of potential legal liability for unwary employers. However, if the test were eliminated, the exemption could be applied to both hourly-wage and salaried workers and only the other two tests—the salary levels and the duties test—would remain as indicators of managerial and professional status. DOL contends that salary remains the general method of compensation for key managerial and professional employees. From the standpoint of employees, the salary-basis test is a key enforcement tool to protect workers from employers who do not comply with the law because it is an objective measure of managerial and professional status. For employees, it is particularly important today because the salary-test levels are so low, and without the salary-basis test, DOL would be left only with the difficult-to-apply duties test as the single test of employer compliance.

In commenting on this report, DOL further explained the rationale for the salary tests. According to DOL, the salary tests have been an integral part of the definitions for the exemptions since 1940. It believes that the statutory terms “executive, administrative, or professional” imply a certain prestige, status, and importance, and an employee’s salary serves as one indicator of his or her status in management or the recognized professions. It is an index that distinguishes the bona fide executive from the working squad leader, or distinguishes the clerk or technician from one who performs true administrative or professional duties. DOL said that salary remains a good indicator of the degree of importance attached to a particular employee’s job, which provides a practical guide, particularly in borderline cases, for distinguishing bona fide executive, administrative, and professional employees from those who were not intended by the Congress to come within the categories of this exemption. In its years of experience in administering the regulations, DOL said it has found no satisfactory substitute for the salary test. The arguments that the salary test is not needed or that it does not help draw the proper line between exempt and nonexempt employees have been offered before, including as part of the hearings and deliberations over amending the regulations in 1940, 1949, and 1958. As then, the DOL sees no new or more valid reasons that have been offered for eliminating the salary test from the regulations than were considered as part of the previous hearings on this question.

Raise the Salary-Test Levels

If the salary-test levels were raised, the regulatory structure could incorporate the effects of inflation and function as originally envisioned. With a higher salary test, both the long and short duties tests would be

applied once again to segments of potentially exempt workers. Nearly everyone we talked to—employers, employees, and experts—agreed that the current salary-test levels are too low and should be increased to higher, more reasonable levels. However, they disagreed sharply on whether the duties tests should remain the same after the salary-test levels were raised.

Employers, particularly retail employers, were opposed to reviving the long duties test and, with it, the percentage limitation on the amount of nonmanagerial work that an exempt employee would be allowed to do. Retail employers argued that the percentage limitations are outdated in modern store management. They said that, in recent decades, store management has changed dramatically. In the 1960s, stores were open for far fewer hours than today and employed one store manager and a full-time workforce. Now, stores are open as much as 24 hours per day, and many part-time workers and managers work each shift. Under these conditions, employers contended that managers must pitch in and work the cash register or stock the shelves, while at the same time managing the store operations.

Union representatives, on the other hand, believe that the long duties test, with its percentage limitations, contains critical criteria for assessing managerial and professional status. They contend that the amount of nonexempt work is a basic indicator of managerial status. They argue that if a worker is engaged in primarily nonexempt work, the worker should be classified as a nonexempt employee, regardless of how his or her employer categorizes the employee's position. Moreover, they argue that the long duties test still allows retail employers to designate the manager in charge of a store as exempt, notwithstanding how much nonexempt work he or she performs, under the so-called "sole charge" exception to the requirement for a limit on nonexempt work.

Add a Category of Knowledge Worker to the Exemptions

This proposal would add a new category of exemption—the knowledge worker—to the executive, administrative, and professional exemptions. This category would include well-paid, highly skilled, nonsupervisory workers who are currently not covered by the exemptions. It would require a new definition of exempt employees, with new criteria and separate salary-test levels.

Employers believe that the current exemptions leave a gap by not including workers who are not engaged in traditional manual labor but

who follow detailed procedures to perform their jobs. Because these workers can be both highly skilled and well paid, employers think that they should be classified similarly to exempt professionals. This would allow both the worker and management more flexibility in scheduling and offer the worker what employers consider prestigious jobs in management positions.

Employee representatives argue against the expansion of the exemptions to include these technical workers. They believe that today's computer-assisted technicians are the modern equivalents of traditional factory workers, and the employee representatives said that there always have been workers who could have been classified as knowledge workers. They think that the same principles underlying the historical limitations on work hours and requirements for overtime pay should apply to the modern workforce. They assert that while everyone would like more flexibility in the work place, in reality exempt status means that employees work longer hours for less pay. And, although they agreed that there are some workers who view working longer hours as a way to management promotion, they think that the majority of workers still would like to have restrictions on the number of hours they can be required to work without additional compensation. Finally, they told us that discretion and independent judgment remain the key indicators of professional and managerial status—rote work, however well paid, shows that a worker is only a “cog in the wheel,” not a key managerial employee.

Adjust Salary Levels and Duties, Applying an Income Ceiling to Nonexempt Status

Finally, another proposal would adjust the salary-basis test, the salary-test levels, the duties tests, and the categories of workers in a new regulatory framework. One basic framework would be similar to that already in the regulations—there would be an income floor below which all workers would be nonexempt, combined with an income ceiling above which workers would be presumed exempt.

As we noted above, although there is nearly universal agreement that the salary levels should be raised, adding an income ceiling is much more controversial. Employers and employees disagree on whether there should be a ceiling, and if so, how high it should be, and what, if any, duties tests should apply to the different income levels.

Issues regarding the ceiling income level include the geographic and industry differences in average salary levels and the possibility of indexing the salary level to increases in average compensation. The questions

related to the duties test involve whether there should be any duties test at all above the ceiling—if not, there would be a conclusive presumption that employees with incomes higher than the ceiling are exempt managerial or professional employees. Alternatively, if some duties test were retained, an employee's exemption could be challenged if his or her duties did not include sufficient managerial or professional responsibilities.

For employers, adding an income ceiling would bring more certainty into the classification of higher-paid workers. Depending on how the duties test for those above the income ceiling was applied, a ceiling could reduce employers' potential liability for violations of the salary-basis test by eliminating the need for the test among the highest-paid workers.

For employees, assuming that there was no applicable duties test, an income ceiling would eliminate the requirement for a 40-hour work-week for higher paid workers. Union representatives believe that, in effect, it would penalize workers for being relatively highly paid. As our data indicated, exempt workers are more likely than nonexempt workers to work more than 40 hours. Employee representatives suggest that the increase in hours of work for exempt employees presents special challenges for the increasing numbers of dual-earner households with middle or upper-middle levels of income. They argue that regardless of income level, it continues to be important that workers have control over both the number and timing of work hours to better balance the competing demands of work and family.

These proposals show how the divergent interests of employers and employees require tradeoffs to resolve the underlying issues with the white-collar exemptions.

Conclusions

The concerns of employers and employees about the operation of the white-collar exemptions in today's work place involve all aspects of the regulatory tests—the salary-basis test, the salary-test levels, and the duties requirements. DOL has not updated these tests in decades, with the result that the salary-level tests are virtually meaningless and there are mounting complaints by employers about ambiguity in the requirements. Although DOL made some efforts to revise the tests in the 1980s, it has not acted because of the difficulty of getting consensus on the changes. Recent attempts to correct the regulatory tests for specific groups—state and local governments and computer professionals—have done little to alleviate the general problems.

Given the economic changes in the 60 years since the passage of the FLSA, it is increasingly important to readjust these tests to meet the needs of the modern work place. However, the different regulatory tests interact with one another, and a change to one test can undermine or strengthen the operation of other regulatory provisions. For example, elimination of the salary-basis test could further weaken the protection offered to the lower-income supervisor who is required to work a 60-hour work-week. Raising the salary levels, on the other hand, adds more complexity to the regulatory tests for executive employees by making the long duties test applicable to at least some workers. Resolution of these concerns requires a careful balancing of the needs of the employers for clear and unambiguous regulatory standards with those of employees for fair and equitable treatment in the work place.

Recommendation

We recommend that the Secretary of Labor comprehensively review the regulations for the white-collar exemptions and make necessary changes to better meet the needs of both employers and employees in the modern work place. Some key areas of review are (1) the salary levels used to trigger the regulatory tests, and (2) the categories of employees covered by the exemptions.

Agency Comments

We provided a draft of this report to the Department of Labor for its review and comments. In its comments, DOL stated that the report was well balanced and accurate in presenting the issues addressed. With respect to the report's recommendation, DOL noted that the white-collar exemption regulations are on its agenda to be reviewed in the future. The Department noted that any change in the current regulatory structure requires balancing the diametrically opposed, conflicting interests of the many and differing constituencies that would be affected, and that the views of interested parties are intractably held on opposite sides of the various issues under these regulations. DOL added that, given the current regulatory environment, the prospects that it could successfully implement consensus changes as we recommended are greatly diminished. In addition, the agency provided other technical comments, which we incorporated in the report as appropriate. (See appendix III for a copy of DOL's written comments.)

We are sending copies of this report to the Honorable Alexis M. Herman, Secretary of Labor; the Honorable Bernard E. Anderson, Assistant Secretary for Employment Standards; the Honorable Katherine G.

Abraham, Commissioner of the Bureau of Labor Statistics; appropriate congressional committees; and other interested parties.

Please call me or Larry Horinko at (202) 512-7001 if you or your staff have any questions about this report. Other major contributors to this report are listed in appendix IV.

A handwritten signature in black ink that reads "Cynthia M. Fagnoni". The signature is written in a cursive, flowing style.

Cynthia M. Fagnoni
Director, Education, Workforce, and
Income Security Issues

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Abbreviations

BLS	Bureau of Labor Statistics
CPS	Current Population Survey
DOL	Department of Labor
FLSA	Fair Labor Standards Act

Scope and Methodology

We used a variety of data sources to develop and provide updated information on the white-collar exemptions. To estimate the number and demographic characteristics of the portion of the American workforce who were executive, administrative, and professional employees covered by the white-collar exemptions in 1998 and 1983, we used the Bureau of the Census' Current Population Survey (CPS) Outgoing Rotations data. To identify statutory and regulatory changes since 1938, we reviewed various legal reports and publications. To determine the major concerns of employers and employees regarding the white-collar exemptions, we reviewed 166 federal court cases on this subject and 66 Department of Labor (DOL) compliance cases, and held discussions with employers, unions, DOL officials, and various legal and economic experts. We performed our work between November 1998 and June 1999 in accordance with generally accepted government auditing standards.

Estimating the Number and Demographics of Workers Covered by the White-Collar Exemptions

To estimate the number and demographic characteristics of exempt white-collar workers, we did not attempt to count the number of employees actually classified as exempt by employers but, rather, to determine how many employees were covered by the regulatory tests for the white-collar exemptions in 1983 and 1998. We reviewed several Bureau of Labor Statistics (BLS) and DOL reports to determine whether any data sources could be used for our purposes. After discussions with DOL and experts, we decided that the CPS Outgoing Rotations was the best available data source to estimate both the proportion of the labor force that is covered by the white-collar exemptions and the demographic characteristics of this population. The CPS is conducted by the Bureau of the Census for the BLS. The Outgoing Rotations data are collected as part of the basic CPS labor-force interview and provide data on weekly earnings along with the demographic information such as age, gender, and race. The CPS is a survey of households collected each month from a probability sample of approximately 50,000 households. The CPS provides self-reported information on the labor-force status of the civilian noninstitutional population 16 years of age and over. Our analysis covered calendar years 1998 and 1983.

General Methodology

To estimate the number of workers covered by the white-collar exemptions using the CPS data, our primary focus was on two questions: (1) Was the worker paid a salary? (2) What was the worker's primary job classification? The CPS data include 905 occupational classifications. Respondents are asked to describe the kind of work they are doing, and

CPS coders classify these duties into one of the 905 job titles. To determine which of the 905 job titles would likely include exempt white-collar workers, we asked the DOL officials to assess the likelihood of exemption for each occupation. DOL officials responded by classifying each of the 905 occupations individually by its likelihood of exemption. Overall, DOL officials determined that 257 of the 905 job titles would likely include exempt workers. For each of these 257 job titles, DOL officials provided us with one of four ranges of likelihood that workers would be covered by the white-collar exemptions: 90-100 percent, 50-90 percent, 10-50 percent, and 0-10 percent.²⁹

To develop our estimate, we analyzed each of the 257 job titles likely to include exempt workers. In determining which of the workers in the sample would likely be exempt and therefore included in our estimate, we applied the percentage ranges provided by the officials at DOL. To better refine the application of these percentage ranges (which were estimates of the likelihood that the positions would include managerial or professional duties), we made the following assumption: duties that make an employee more likely to be covered by the white-collar exemptions are duties that, generally speaking, elicit a higher salary. Under this assumption, as workers have more exempt duties and responsibilities, their incomes increase—as does the likelihood of being exempt. Therefore, we applied the percentage ranges provided by DOL officials to give increasing weight to workers with higher incomes. All workers, except physicians, lawyers, and teachers, earning less than \$250 per week were considered nonexempt and were eliminated from our calculation of the exempt population. The exemption for physicians, lawyers, and teachers does not depend on the income of the employee.

Using this method for each of the 257 occupations, we generated our estimates for the low and high estimates of the potentially exempt population for both 1983 and 1998. After we estimated the population covered by the white-collar exemptions, we determined its demographic characteristics. Our analysis included information on gender, industry, weekly earnings, and overtime hours worked.

Our work presents data for six industry groupings: (1) services; (2) retail trade; (3) manufacturing; (4) finance, insurance, and real estate; (5) public sector; and (6) other. We developed these groups by combining 932 detailed CPS industry codes. The service sector includes four types of service occupations: business and repair, entertainment and recreation,

²⁹These ranges were not overlapping since each occupation is assigned a different range.

professional and related services, and personal services. Retail trade includes all types of retail stores. Manufacturing includes durable and nondurable goods. The finance, insurance, and real estate category includes banking, credit agencies, security companies, and insurance and real estate offices. Public sector includes federal, state, and local government workers. The final category, other industries, includes agriculture, forestry, fishery, mining, construction, wholesale trade, transportation, communications, public utilities, and public administration.

**Data Limitations Related to
the Use of the CPS**

There are two major limitations on the use of CPS data. First, the CPS occupational classifications do not distinguish between supervisory and nonsupervisory employees, which is important for the long and short duties tests under the Fair Labor Standards Act (FLSA). Therefore, one job title, “managers and administrators,” could include the President of General Motors, but it may also include an office assistant. Second, CPS respondents self-identify their duties and some may tend to exaggerate them. This may result in overestimates of the number of management employees and, consequently, may overestimate the number of exempt employees.

We corrected for these data limitations by giving increasing weight to workers with higher incomes and by applying the percentage ranges provided by DOL officials.

Sources of Uncertainty

There are two sources of uncertainty in our estimation of the potentially exempt population.

The first source of uncertainty is methodological and related to the probability of exemption for each occupation. DOL officials provided us with one of four ranges of likelihood of exemption for each occupation. Our low estimate is based on the lowest likelihood of exemption in each of the four ranges and our high estimate is based on the highest likelihood in each range.

The second source of uncertainty is sampling error, due to our use of the CPS survey of households. Rather than counting the number of employees actually classified as exempt by employers, we estimated how many employees are likely to be classified as exempt, based on the occupational classifications and income reported in the CPS sample.

The high and low estimates we report reflect the methodological uncertainty, which is much larger than the sampling error. For example, consider table 2. The table shows that the high estimate of workers covered by the white-collar exemptions in 1983 is 17 million. For the same year, our low estimate is 12 million workers. The difference between the high and low estimate—5 million workers—is the amount of uncertainty due to methodological process we describe as our first source of uncertainty. On the other hand, the sampling error—the second source of uncertainty—involves an estimated error of plus or minus 700,000 people.

Identification of Statutory and Regulatory Changes

We reviewed legislative references to identify changes to the FLSA. For the regulatory changes, we reviewed annual publications of the Code of Federal Regulations for the period 1959 to the present; for the period 1938 to 1959, we relied on three DOL hearing reports provided to us by DOL.

Determination of the Major Concerns of Employers and Employees

To obtain information on the major concerns of employers and employees about the white-collar exemptions, we used four sources: (1) review of federal court decisions involving white-collar exemption issues over the 5-year period from January 1994 through December 1998; (2) review of DOL compliance cases related to white-collar exemptions that were closed in the 2-year period between January 1997 through December 1998 in four DOL field offices; (3) interviews with individuals and groups representing the interests of employers; and (4) interviews with individuals and groups with knowledge about the interests of employees. In the paragraphs below, we present more detail on each of these sources.

Review of Federal Court Cases

We reviewed 166 judicial opinions from federal appellate and district courts involving litigation related to the white-collar exemptions during the 5-year period from 1994 through 1998. To identify these cases, we conducted a computer search of federal opinions in this period.³⁰ We categorized each of the 166 cases as being related to one of four issues: the salary-basis test, the executive classification, the administrative classification, or the professional classification. For cases involving more than one white-collar exemption issue, we selected one issue to be the primary issue. In addition to the primary issue, we also collected data on other circumstances of each case, such as who prevailed on the issue and whether the case involved multiple employees suing their employer.

³⁰To avoid double counting, we eliminated district court cases that were later heard by an appellate court, and we only used the appellate decision in our sample.

Review of DOL
Compliance Cases

We supplemented our review of federal court decisions with a review of 66 DOL compliance cases from 4 of its 57 District Offices. At our request, the four District Offices—in the Northeast (Boston), South (Richmond), Midwest (Chicago), and West (Los Angeles)—identified compliance cases closed in the 2-year period between January 1997 and December 1998 that involved white-collar issues. Each office identified cases that we reviewed and discussed with district managers and investigators who were familiar with the cases. As with the federal court decisions, we categorized each of the cases as being related to one of four issues: the salary-basis test, the executive classification, the administrative classification, or the professional classification.

Employer Perspectives

To identify the key concerns of employers related to the white-collar exemptions, we met with private and public employers, trade associations, DOL officials, and various legal and economics experts. The Society for Human Resource Management, a group of human resource managers from companies with over 100 employees, organized two group sessions—one with banking and insurance human resource managers, and the other with manufacturing human resource managers. We also met with the Labor Policy Association—a group representing companies with business operations in the United States and with more than 2,500 employees each. In addition to these company managers, we met with attorneys and associations representing manufacturing companies, retail companies, and small businesses. On the public employment side, we met with representatives from various cities and public employer groups, as well as separately with four legal experts representing public employers across the country. Finally, we met with DOL officials in the Wage and Hour Division and the Office of the Solicitor.

Employee Perspectives

To identify the concerns of employees, we met with union representatives and officials, DOL officials, and legal and economic experts. We met with the American Federation of Labor-Congress of Industrial Organizations and officials from nine different unions and trade union representatives. We also interviewed several legal and economic experts who specialize in issues relating to the FLSA and, in particular, white-collar exemptions.

Statutory and Regulatory History of FLSA White-Collar Exemptions

The Fair Labor Standards Act at sec. 13(a)(1) established the so-called white-collar exemptions: any employee in a “bona fide executive, administrative, or professional capacity” is exempted from the minimum wage and overtime requirements of the FLSA. After the original enactment of the FLSA in 1938, the Department promulgated regulations (at 24 C.F.R. part 541) defining the terms included in section 13(a)(1). Since 1938, there have been changes to both the statute and the regulations. In the following tables, we outline these changes.

Table II.1: Statutory History of FLSA Section 13(a)(1) on White-Collar Exemptions, 1938-1998

Year	Legislation	Summary of change
1938	Fair Labor Standards Act of 1938 (P.L. 75-718)	As originally enacted in 1938, sec. 13(a)(1) provided that the minimum wage (section 6) and overtime provisions (section 7) of the FLSA did not apply to “any employee employed in a bona fide executive, administrative, professional, or local retailing capacity.”
1961	Fair Labor Standards Amendments of 1961 (P.L. 87-30)	This amendment limited the exemption for retail employees. It eliminated the separate exemption category for workers employed in a “local retailing capacity.” This separate exemption was replaced with a proviso that an employee of a retail or service establishment could not be excluded from the definition of executive or administrative capacity because of the amount of time devoted to other than executive or administrative activities if less than 40 percent of his or her work hours included such activities.
1966	Fair Labor Standards Amendments of 1966 (P.L. 89-601)	In 1966, public educational institutions were made subject to the requirements of the FLSA. However, this amendment exempted academic administrative personnel and teachers in elementary and secondary schools from these requirements by expressly including them under sec. 13(a)(1).
1972	Education Amendments of 1972 (P.L. 92-318)	This amendment made the equal-pay provision of the FLSA at sec. 6(d) applicable to employees who were otherwise exempt from the FLSA under sec. 13(a)(1).
1996	Small Business Job Protection Act of 1996 (P.L. 104-188)	This amendment, enacted into law at sec. 13(a)(17) of the FLSA, contains the description of computer professionals who are exempt employees. By its terms, employees who meet the duties test of the exemption are exempt from the FLSA as long as they earn not less than \$27.63 per hour.

Source: GAO analysis of applicable laws and legislative history.

Appendix II
Statutory and Regulatory History of FLSA
White-Collar Exemptions

Table II.2: Regulatory History of 29 CFR Part 541, Defining FLSA White-Collar Exemptions, 1938-1998

Year	Federal Register notice of regulation change	Part 541 subsections affected	Summary of change
1938	3 Fed. Reg. 2518, Oct. 20, 1938	Regulation included subsec. 1-5	The Fair Labor Standards Act of 1938 in sec. 13(a)(1) exempted “any employee employed in a bona fide executive, administrative, professional or local retailing capacity” from the requirements of the Act. To define these terms, part 541 was added to the Department regulations in 29 C.F.R. chapter V. The new regulations defined these exempt employees, as follows: —The new regulation combined executive and administrative at sec. 541.1 to include any employee whose primary duty is the “management of the establishment, or a customarily recognized department thereof” and who “customarily and regularly directs the work of other employees therein.” It also set a salary level—to be exempted, an employee had to be compensated at not less than \$30 per week. —Separate definitions were included for professional employees (sec. 541.2: “customarily and regularly engaged in work predominantly intellectual and varied in character as opposed to routine mental, manual, mechanical or physical work”) and retail employees (sec. 541.3: “customarily and regularly engaged in making retail sales”). There was no salary limit for either professional or retail employees.
1940	5 Fed. Reg. 4077, Oct. 15, 1940	Regulation revised subsec. 1-5, adding new sec. 2	In accommodating the views of interested employers, employees, trade associations, and unions, the Department revised the definitions of executive, administrative, and professional to include separate duties and salary tests for each type of exempt employee. These revisions included the following: —For executive employees, the revised regulations at sec. 541.1 retained much of the original language, but specified that the employee could not spend more than 20 percent of the work-week on “work of the same nature as performed by nonexempt employees” unless in “sole charge” of an independent establishment. The executive was to be paid on a salary basis at least \$30 per week. —Administrative employees were newly defined in sec. 541.2 as those employees who performed nonmanual work that required the exercise of discretion and independent judgment. The administrative employee was to be paid on a salary or fee basis at least \$200 per month. —For professional employees, the regulations in sec. 541.3 added a new requirement that they either had knowledge of an advanced type in a field of science or learning or performed work predominantly original and creative in character. They also had to be paid on a salary or fee basis at least \$200 month unless they were licensed doctors or lawyers.
1942	7 Fed. Reg. 332, Jan. 17, 1942	Revised subsec. 2	This revision added para. (b)(4) to the definition of administrative employees, specifically exempting employees engaged in transporting goods or passengers for hire. According to a 1949 DOL report, this provision was intended to exempt employees engaged in ferrying airplanes. (This provision was eliminated in 1949.)

(continued)

Appendix II
Statutory and Regulatory History of FLSA
White-Collar Exemptions

Year	Federal Register notice of regulation change	Part 541 subsections affected	Summary of change
1949	14 Fed. Reg. 7705, Dec. 24, 1949	Revised subsec. 1-6	After 10 years of administrative experience, the Department once again revised the regulations. For the most part, these changes resulted from recommendations from the DOL's regional directors and field staff. Among other things, the changes included the following: —A special “upset” test was added to the tests determining administrative, executive, or professional employees: if the employee made at least \$100 per week (a “high-salaried” employee), then he or she only had to meet a “short-cut” version of the original long duties test. —The basic salary test was increased: executives had to make at least \$55 per week; administrators, at least \$75 per week; and professionals, at least \$75 per week. —For executives, the regulations specified that they must supervise two or more employees.
1949	14 Fed. Reg. 7730, Dec. 28, 1949	Added new Subpart B—Interpretations	To respond to requests from its field staff for explanatory material on the 541 regulations, the DOL published an explanatory bulletin. This bulletin, added to the regulation as Subpart B, contained statements of general policy directly related to the 541 regulations. Among other things, the bulletin: —Elaborated upon the terms included in subsec. 1-6; such terms included primary duty (541.103), sole charge (541.113) and salary basis (541.118). —Added new terms to the regulations, such as working foremen (541.115) and combination exemptions (541.600). —Applied the regulations to specific professions, such as newspaper reporters (541.303f) and radio announcers (541.303e).
1953	18 Fed. Reg. 3930, July 7, 1953; error in original notice corrected by 18 Fed. Reg. 4098, July 14, 1953	Added subsec. 5(a) and 601	Subsec. 5a made the requirement that exempt employees be paid on a salary basis not applicable to employees in the motion-picture-producing industry who were compensated at certain minimum rate, and subsec. 601 explained how to apply this provision.
1954	19 Fed. Reg. 4405, July 17, 1954	Revised subsec. 118	Subsec. 118, which explains the salary-basis test, was revised, in principal part, as follows: —Subsec. 118(a) specified that an employee must receive a full salary “without regard to the number of days or hours worked.” This revision explained the application of this rule to different pay deductions; for example, an employer cannot deduct pay for a lack of work (541.118(a)(1)) or for personal absences of less than 1 day (541.118(a)(2)) or for jury duty (541.118(a)(4)). —In addition, a new subsec. 118(a)(6) allowed an employer, under certain circumstances, to correct improper pay deductions if the employer reimbursed the employee and promised to comply in the future (the so-called window of correction).
1958	23 Fed. Reg. 8962, Nov. 18, 1958	Revised subsec. 1, 2, and 3	This revision increased the salary tests for exempt employees: —Executive employees had to be paid at least \$80 per week; administrative employees, at least \$95 per week; and professional employees, at least \$95 per week. —The so-called “upset test” for high-salaried employees was also increased to \$125 per week for all three types of exempt workers.

(continued)

Appendix II
Statutory and Regulatory History of FLSA
White-Collar Exemptions

Year	Federal Register notice of regulation change	Part 541 subsections affected	Summary of change
1959	24 Fed. Reg. 581, Jan. 27, 1959	Revised subsec. 100, 117, 118, 119, 200, 211, 300, 311, 313, 315, 600	This revision adjusted the provisions in Subpart B—Interpretations to match the salary test increases published in November 1958.
1961	26 Fed. Reg. 8635, Sept. 15, 1961	Revised subsec. 1, 2, 3, 99, 100, 101, 105, 109, 112, 113, 114, 200, 209, 300, 308; revoked subsec. 4, 400, 401, 402, 403	This revision implemented the Fair Labor Standards Amendments of 1961, which eliminated the exemption for employees in a “local retailing capacity.” The amendments replaced it with a proviso that retail employees could not be excluded from the executive or administrative exemptions because of the amount of time they spent performing activities that are not managerial or administrative if less than 40 percent of the employee’s time was devoted to such activities.
1963	28 Fed. Reg. 9505, Aug. 30, 1963, typographical error in original notice corrected by 28 Fed. Reg. 14423, Dec. 28, 1963	Revised subsec. included 1, 2, 3, 100, 105, 108, 109, 112, 113, 117, 118, 119, 200, 201, 202, 205, 207, 209, 211, 300, 311, 315, 600; added subsec. 5b	This revision updated Subpart B—Interpretations to include illustrative examples relating to retail work. It also increased the salary test for exempt employees: —Executive employees had to be paid a salary of at least \$100 per week; administrative employees, at least \$100 per week; and professional employees, at least \$115 per week. —The upset test triggering the short duties test was increased to \$150 per week for all three types of exempt employees. —The increased salary test was not effective for retail employees until September 3, 1965.
1967	32 Fed. Reg. 7823, May 30, 1967	Revised subsec. included 1, 2, 3, 112, 200, 201, 202, 300, 302, 304, 307, 314, 315, 602	This revision was made to implement the changes in the law made by the Fair Labor Standards Amendments of 1966, which made public educational institutions subject to the FLSA for the first time. It also amended the Act to specifically include academic administrative personnel and teachers in elementary and secondary schools in sec. 13(a)(1). The regulatory changes pursuant to this amendment included, among other things: —Subsec. 2 was expanded to specify an administrative exemption for performance of administrative functions in a school system. —Subsec. 3 included a professional exemption for teachers in a school system or educational establishment. —Teachers, as well as doctors and lawyers, were excepted from the requirement for a minimum salary level.
1970	35 Fed. Reg. 883, Jan. 22, 1970 (35 Fed. Reg. 3220, Feb. 20, 1970, extended the effective date of the salary increase)	Revised subsec. 1, 2, 3, 5b, 100, 117, 118, 119, 200, 211, 214, 300, 311, 313, 315, 600; revoked subsec. 200 and 300	These revisions increased the salary test for exempt employees: —Executive employees had to be paid at least \$125 per week; administrative employees, at least \$125 per week; and professional employees, at least \$140 per week. —The upset test triggering the short duties test was increased for all three types of employees to \$200 per week.
1971	36 Fed. Reg. 22976, Dec. 2, 1971	Revised subsec. included 103, 207, 302	These revisions to Subpart B included additional explanatory guidelines for paramedical and data-processing employees, as well as for the professional exemption.
1973	38 Fed. Reg. 11390, May 7, 1973	Revised subsec. included 1, 2, 3, 52, 117, 118, 119, 214, 311, 313, 315, 601	These revisions reflect the changes made in the law by the Education Amendments of 1972, which made the equal-pay provision of the FLSA applicable to otherwise-exempt employees.

(continued)

Appendix II
Statutory and Regulatory History of FLSA
White-Collar Exemptions

Year	Federal Register notice of regulation change	Part 541 subsections affected	Summary of change
1975	40 Fed. Reg. 7092, Feb. 19, 1975	Revised subsec. 1, 2, 3, 117, 118, 119, 211, 214, 311, 313, 315, 601	These revisions increased the salary test for exempt employees: —Executive employees had to be paid at least \$155 per week; administrative employees, at least \$155 per week; and professional employees, at least \$170 per week. —The upset test triggering the short duties test was increased for all three types of employment to \$250 per week.
1981	46 Fed. Reg. 3010, Jan. 13, 1981 (postponed indefinitely); 46 Fed. Reg. 11972, Feb. 12, 1981; and 46 Fed. Reg. 11972, Feb. 12, 1981	Revised subsec. 1, 2, 3, 117, 118, 119, 211, 214, 311, 313, 315, 601; revoked subsec. 52	These revisions, which were indefinitely postponed by Presidential memorandum of Jan. 29, 1981, would have increased the salary test for exempt employees: —Executive employees would have had to be paid at least \$225 per week; administrative employees, at least \$225 per week; and professional employees, at least \$250 per week. In 2 years, these base salaries would have been raised to \$250 per week for executive and administrative employees, and to \$280 per week for professional employees. —The upset test triggering the short duties test would have increased for all three types of employment to \$320 per week. In 2 years, this test would have been raised to \$345 per week.
1991, 1992	56 Fed. Reg. 45824, Sept. 6, 1991, as revised and finalized at 57 Fed. Reg. 37666, Aug. 19, 1992	Added subsec. 5d	This new subsection was added in response to conflicting court decisions and the accompanying confusion, and the need to treat public employees differently than private employees because of the requirement for public accountability. It made the requirement of payment on a salary basis generally, but not completely, inapplicable to exempt state and local employees.
1992	56 Fed. Reg. 8250, Feb. 27, 1991, as finalized at 57 Fed. Reg. 46742, Oct. 9, 1992 (corrected by 57 Fed. Reg. 47163, Oct. 14, 1992)	Revised subsec. 3, 5c, 302, 312; added subsec. 303	This revision implemented sec. 2 of P.L. 101-583 which directed the Secretary of Labor to promulgate regulations that permitted computer systems analysts, computer programmers, software engineers, and other similarly skilled workers to be classified as exempt employees. As specified by the law, these revisions exempted workers whose duties met the new test set forth in the regulation and, if they were paid on a salary basis, their pay met the specified salary test levels; or, if they were paid on an hourly basis, their regular rate of pay exceeded 6-1/2 times the minimum wage. ^a

Source: GAO analysis of applicable regulations.

^aP.L. 104-188 subsequently set the hourly wage that would allow employers to claim an exemption for computer workers at \$27.63 per hour, but no corresponding change was made in the regulations.

Comments From the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employment Standards
Washington, D.C. 20210



AUG 25 1999

Ms. Cynthia Fagnoni
Director, Education, Workforce,
and Income Security Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Ms. Fagnoni:

Thank you for the opportunity to comment on your draft report entitled "FAIR LABOR STANDARDS ACT: Employers' and Employees' Concerns About White Collar Exemptions in the Modern Workplace."

Overall, we found the report to be well-balanced and accurate in its presentation of the issues addressed. We offer the following observations on certain aspects of the draft report.

Now on p. 7.

We found the report's use of the short-form expression "duties time test" to be confusing (e.g., Table 1, page 7). DOL refers to this test as the exemptions' percentage limitations on employees performing non-exempt work.

Now on p. 9.

Regarding Figure 1 on page 9, it would be beneficial to include a separate additional chart showing the change in numbers (as opposed to the percentages) in each industry sector given the growth in the workforce.

Now on p. 12.

Regarding Figure 4 on page 11, it is our understanding that the amount of overtime work being performed is still near historical highs. It would be useful to include a chart that shows overtime trends over a period of time (see, e.g., Economic Indicators: July 1999, GPO, page 15, copy enclosed).

Now on p. 13.

Regarding Figure 5 on page 12, it would be beneficial to include the actual number of full-time exempt white collar workers (in addition to the percentages) at various earnings levels, to show the order of magnitude of the universe.

Now on pp. 17-19.

In the discussion of employer complaints on the pay docking issue (pages 15-16), we would note that there is a basic fairness issue here. Employers properly claiming the exemption never have to pay an exempt employee for hours worked over 40 in

Working for America's Workforce

the week, yet their complaints against pay docking would suggest employers also want to not pay an employee's full salary when fewer than 40 hours are worked in a week.

Now on p. 18.

In footnote 18 on page 17, for clarity, it would be useful to note that the Alden v. Maine Supreme Court decision related to lawsuits filed against a state in State courts, which followed from the earlier Supreme Court decision in Seminole Tribe of Fla. v. Florida (517 U.S. 44), addressing the sovereign immunity of States from similar lawsuits in federal courts.

Now on p. 19.

In the discussion of confusion "because case law has not been settled" (pages 17 - 18), we believe that some of the employer assertions are not supportable because they have, in fact, been addressed authoritatively in either the case law or the law itself. For example, in the Auer v. Robbins Supreme Court case cited, a single instance of pay docking (a two-day suspension without pay for one employee under unusual circumstances) represented the actual practice reviewed by the Court that caused the exemption to be lost, which could be corrected by reimbursement and the employer's promise of future compliance under 29 CFR § 541.118(a)(6). In addition, under Section 102(c) of the Family and Medical Leave Act (29 USC 2612(c)) and its implementing regulation, 29 CFR § 825.206, an employee who otherwise meets all requirements for the exemption does not lose the exemption where the employer provides unpaid leave in partial day increments. Further, additional compensation paid besides the salary, including hourly overtime payments, will not invalidate an otherwise applicable exemption pursuant to the express regulatory provision at 29 CFR § 541.118(b). And, based on the regulatory policy in 29 CFR § 541.118(a) under which a salaried employee need not be paid for any workweek in which he or she performs no work, but must receive the full salary for any week in which any work is performed (subject to the permissible deductions further stated in that section), it is clear that an employer may not suspend an employee without pay for less than a full workweek (see, e.g., Auer), but must limit such disciplinary actions to full-week increments. An employer may also discipline an employee by other means which do not affect the employee's compensation without losing the salary basis component of the exemption.

Now on p. 20.

In the discussion on page 19 of the history behind DOL's longstanding view that the salary test is one of the best indicators of managerial and professional status, the draft report cites only a passage from the 1949 report on proposed changes to the regulations. For proper context, it would be

beneficial to also cite the earlier findings from the 1940 hearing officer's report. As reported in 1940,

"... The term "executive" implies a certain prestige, status, and importance. Employees who qualify under the definition are denied the protection of the act. It must be assumed that they enjoy compensatory privileges and this presumption will clearly fail if they are not paid a salary substantially higher than the wages guaranteed as a mere minimum under section 6 of the act. In no other way can there be assurance that section 13(a)(1) will not invite evasion of section 6 and section 7 for large numbers of workers to whom the wage-and-hour provisions should apply. Indeed, if an employer states that a particular employee is of sufficient importance to his firm to be classified as an "executive" employee and thereby exempt from the protection of the act, the best single test of the employer's good faith in attributing importance to the employee's services is the amount he pays for them. The reasonableness and soundness of this conclusion is sustained by the record."

Now on p. 20.

"Stein Report," October 10, 1940, page 19. These principles were also reaffirmed in the report and recommendations of the hearing officer on proposed revisions to the regulations in 1958 ("Kantor Report," March 3, 1958, pages 2 - 4). These three DOL hearing reports are cited as source materials on page 42 of the draft report.

Now on p. 31.

In the discussion of a proposal to eliminate the salary basis test on page 31, a fuller discussion of the rationale behind it would further support DOL's views for retaining it as an appropriate indicator of managerial or professional status. The salary tests have been an integral part of the definitions for exemption since 1940. The statutory terms "executive, administrative, or professional" imply a certain prestige, status and importance, and an employee's salary serves as one indicator of his or her status in management or the recognized professions. It is an index that distinguishes the *bona fide* executive from the working squad leader, or distinguishes the clerk or technician from one who performs true administrative or professional duties. Salary remains a good indicator of the degree of importance attached to a particular employee's job, which provides a practical guide, particularly in borderline cases, for distinguishing *bona fide* executive, administrative and professional employees from those who were not intended by the Congress to come within the categories of this exemption. In the years of experience in administering the regulations, DOL

Appendix III
Comments From the Department of Labor

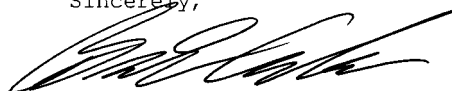
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has found no satisfactory substitute for the salary test. The arguments that the salary test is not needed or that it does not help draw the proper line between exempt and non-exempt employees have been offered before, including as part of the hearings and deliberations over amending the regulations in 1940, 1949, and 1958. As then, we see no new or more valid reasons that have been offered for eliminating the salary test from the regulations than were considered as part of the previous hearings on this question.

With respect to the draft report's recommendation that DOL comprehensively review the regulations and make necessary changes to better meet the needs of *both* employers and employees in the modern workplace, these regulations are included in DOL's agenda of regulations selected for review in the future. We would also point out, however, as the draft report acknowledges, that any change in the current regulatory structure requires balancing the diametrically opposed, conflicting interests of the many and differing constituencies that would be affected. The views of interested parties are intractably held on opposite sides of the various issues under these regulations. Given the current regulatory environment, this greatly diminishes the prospects at the executive agency level for successfully implementing consensus changes as the GAO recommends.

Again, I would like to thank you for the opportunity to comment on your draft report.

Sincerely,



Bernard E. Anderson

Enclosure

GAO Contacts and Staff Acknowledgments

GAO Contacts	Larry Horinko, (202) 512-7001 Nancy Peters, (202) 512-9065
Staff Acknowledgments	In addition to those mentioned above, Carol Patey, Bill Hansbury, Rich Kelley, Kelly Mikelson, Charlie Jeszeck, and Robert Crystal made key contributions to this report.

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