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# FAIR LABOR STANDARDS ACT

# White-Collar Exemptions Need Adjustments for Today's Work Place

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# Fair Labor Standards Act: White-Collar Exemptions Need Adjustments for Today's Work Place

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me here today to speak about the white-collar exemptions to the Fair Labor Standards Act (FLSA). For more than 60 years, the FLSA has set the minimum wage and hour standards for the vast majority of American workers. The exceptions to these standards that affect the most workers are the so-called white-collar exemptions, covering employees working in a bona fide executive, administrative, or professional capacity.

My remarks today focus on (1) how shifts in the American economy have affected the exemptions in today's work place, (2) how the regulations underpinning the exemptions have changed in the decades since the enactment of the FLSA, (3) why both employer and employee representatives believe that adjustments are needed to update the regulatory structure, and (4) why the need to balance the interests of both employers and employees suggests that comprehensive review is key to equitable regulatory reform. My testimony is based primarily upon a September 1999 report we issued to the Subcommittee.[1]

In summary, our data showed that an increasing number of American workers are covered by the exemptions—we estimate that between 19 and 26 million workers (between 20 to 27 percent of the full-time workforce) were covered by the exemptions in 1998. Based on our 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. The rapidly growing services sector had a higher proportion of exempt workers than other sectors, and is responsible for much of the overall increase in numbers of exempt workers. Similarly, our data indicated that more women than men entered full-time white-collar exempt positions over this period. Despite these shifts in the American work place, there have been few changes in the laws and regulations establishing the exemptions since 1954. For most American workers, the rules for determining whether they are exempt from the FLSA, and thus its requirements for overtime pay, have remained largely unaltered in the past 46 years.

[1] *Fair Labor Standards Act: White-Collar Exemptions in the Modern Work Place* (GAO/HEHS-99-164, Sept. 30, 1999).

From the prospective of either the employer or the employee, the exemption rules are overdue for adjustment. For employers, the rules have become increasingly rigid and inflexible, particularly in view of the technological advances in the work place. For employees, inflation and oversimplification have reduced the protections formerly provided by the regulations. As currently set, the rules provide far less protection for the worker, particularly for lower-income supervisors. However, equitable adjustment of the regulatory structure is difficult, requiring a balance of the often-conflicting interests of employers and employees. Because the regulations are made up of many interlocking provisions intended to balance these competing interests, piecemeal corrections can lead to unsatisfactory results. Accordingly, we have recommended that the Secretary of Labor comprehensively review the regulations and adjust the entire regulatory structure as needed, carefully balancing the needs of employers for clear and unambiguous regulatory standards with those of employees for fair treatment in the work place.

## Background

The FLSA sets the minimum wage most employers must pay their employees and the maximum hours—40 hours per week—most employees can work without receiving extra, overtime premium pay. The largest group of workers exempt from the FLSA are those classified as executives, administrators, or professionals. For employers and employees, the practical consequences of exempt worker classification can be very important. An exempt employee can 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 over 40.

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 the use of the exemptions. Balancing these competing interests, the Department of Labor (DOL) established specific regulatory tests that must be met before an employee can be classified as an exempt white-collar employee. DOL compliance investigators use these tests to determine whether employers have properly complied with the law. In general, there are three major parts to these tests for determining if an employee is exempt from the FLSA:

- First, the employee must be paid on a salary basis, not an hourly rate.
- Second, the employee must be paid at least a specified base salary level that is supposed to indicate managerial or professional status.

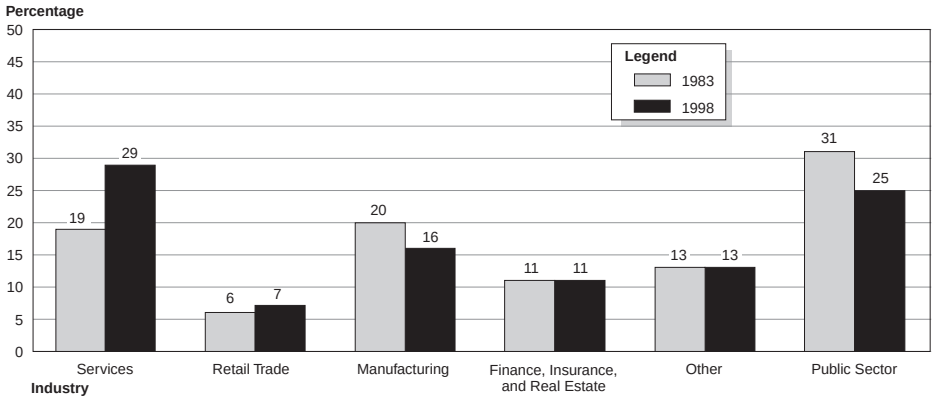
- Third, the employee must have duties and responsibilities associated with managerial or professional work. Generally, such duties must require the employee to exercise independent judgment and discretion.

## Number of White-Collar Exemptions Increases With Growth of the Service Sector and Among Women

Two major shifts have significantly reshaped the American workforce: (1) the general shift of industry from manufacturing to service, and (2) the influx of women into the work place. Our data indicate that service industry workers are more likely to be classified in exempt white collar positions and that an increasing portion of women are being classified as exempt. In general, exempt white-collar workers are increasingly much more apt to work overtime hours on their jobs than are workers in nonexempt positions.

Our data showed a general increase in white-collar exempt positions between 1983 and 1998, and much of the growth in these positions can be attributed to the expansion of the service industries related to business and repair services, entertainment, and recreation, as well as professional and personal services. These service industries grew more rapidly than any other sector during the 15-year period, nearly doubling from 13 million employees in 1983 to 24 million employees in 1998. Along with this expansion, the percentage of white-collar exempt employees jumped from 19 percent to 29 percent within these service industries, far higher than any other industry sector (see fig. 1). The increase in the number of exempt workers in this sector—about 3.6 million employees—represented almost 50 percent of the overall growth in exempt employees.

**Figure 1: Percentage of Full-Time White-Collar Workers Exempt in 1983 and 1998, by Industry**




Note: The percentage estimates represent the average of GAO high and low estimates.

Source: Current Population Survey Outgoing Rotations Data for 1983 and 1998.

Likewise, the numbers of working women grew significantly, and women were increasingly more likely to be part of the exempt workforce. In 1998, 42 percent of the exempt workers were women, compared to 33 percent in 1983. This was a much larger change than the percentage of women in the nonexempt workforce, which grew only slightly (about 1 percent) in the 15-year period.

Overall, 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. In 1998, 44 percent of the full-time exempt workers said that they worked overtime, increasing from 35 percent in 1983. In contrast, only 19 percent of nonexempt employees worked more than 40 hours per week at their main job in 1998.

## Basic Regulatory Tests for Exemptions Largely Unchanged in 46 Years

In the 16 years following the enactment of the FLSA in 1938, DOL used its increasing experience with the administration of the regulations to define fully who can be classified as exempt executive, administrative, or professional employees. Since 1954, the definitions have stayed nearly the same, although the extent of the coverage of the exemptions has been modified. Table 1 describes the major statutory and regulatory revisions to the white-collar exemptions.

**Table 1: 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. |
| 1966/1967 | FLSA was applied to public educational institutions but teachers and school administrators were included under the exemption. |
| 1972/1973 | 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. |
| 1992 | Certain computer professionals earning over 6½ 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.

For most employees, the only regulatory changes to the tests since 1954 have involved upward adjustment of the salary levels specified as indicative of managerial or professional status. These salary levels were adjusted in 1958, 1963, 1970, and 1975. However, there has been no inflation adjustment for these salary levels in the 25 years since 1975.

## Both Employers and Employees Call for Adjustments

From very different points of view, both employers and employee representatives agree that the white-collar regulations need adjustment. Employers, arguing that the regulations are too complicated and outdated for modern work places, cited major concerns involving the rigidity and ambiguity of various regulatory tests. Employee representatives, on the other hand, urged changes in certain aspects of the tests, such as increasing the levels of the salary tests, to better protect workers, particularly lower-income supervisors.

## Employers Stress Need for Clarity and Flexibility

From our discussions with employers, DOL officials, and various legal and economic experts, as well as our review of federal court cases and DOL compliance cases, three issues stood out as being of particular concern to employers:

- First, the employers believe that 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, employers contend that traditional distinctions in the application of the white-collar exemptions to two groups—highly paid, very skilled nonexempt production workers, and exempt professional and administrative employees—are no longer valid 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.

I will now provide some details on each of these three issues.

### Salary-Basis Test

First, DOL regulations specify that employees can be exempt executives, administrators, or professionals only if they are paid on a salary basis—that is, employers must pay them a full salary for any week worked regardless of the number of days or hours worked. Under this rule, employers 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. Moreover, employers cannot suspend exempt employees without pay for less than 1 week for such things as tardiness or unexplained absenteeism. Supporting this rule, DOL officials referred to a longstanding belief that salary basis is "almost universally recognized as the only method of payment consistent with the status of the 'bona fide' executive."

Employers object to this rule because compliance requires adherence to the no-docking requirements, limiting their ability to hold their employees accountable for their time and actions. In the 5-year period from 1994 through 1998, about one-half of the 166 federal court cases we reviewed involved suits by employees against their employers alleging violations of the salary-basis test. However, the large majority of these cases were brought by groups of public managerial employees (such as police chiefs and fire chiefs) against their government employer because the employer could suspend, or had suspended, the

pay for less than 1 week of exempt employees for disciplinary infractions.

A 1997 Supreme Court case, Auer v. Robbins, reduced employers' potential for liability in such cases by requiring that employees show an actual practice or significant likelihood of pay docking by their employers. In addition, the Court expressly deferred to the Secretary of Labor as the expert on regulatory interpretation of the salary-basis test. Notwithstanding this case, employers we talked to and cases we reviewed indicated some remaining uncertainty about the limits of the test. Furthermore, certain employers (such as retail chain stores and some large public employers) still strongly contend that the rule unnecessarily impinges on proper management of their employees.

## Limitations on Exemption of Production Workers

The second major issue for employers dealt with the traditional limits of the white-collar exemptions. Ever since the enactment of the FLSA, nonsupervisory technical workers without professional degrees involved in the manual production of goods have been treated as nonexempt, no matter how highly skilled or how highly paid an individual worker may be. Employers believe that certain well-paid technicians have skills equivalent to those of a professional worker, and should be treated as exempt workers.

To illustrate the point, one manufacturing company official described the job of technicians who monitor remote, automated factories around the country using standardized instruments. The official compared the jobs of these well-paid (about $70,000 per year) technicians with those of her company's professional engineers. Both groups held similar jobs and earned comparable pay. However, because the engineers had professional degrees while the technicians did not, the company had to treat the technicians as nonexempt and the engineers as exempt employees.

## Independent Judgment and Discretion

The third issue relates to one aspect of the regulatory tests involved in the DOL compliance cases that we reviewed—the requirement that an exempt administrator or professional exercise independent judgment and discretion in carrying out his or her job duties. To assess whether an employee is properly classified as exempt, DOL compliance investigators must determine whether the employee's job includes sufficient independent judgment or discretion. To do this, an investigator must look not only at the general duties described as part of the position, but also at the specific duties the employee actually performs. Thus, even though an accountant may have been hired into a position requiring full professional certification, the accountant would

be nonexempt if his or her major tasks are actually closely supervised, primarily involving rote work with set procedures.

Our discussions with employers and DOL investigators indicated that this aspect of the regulations is particularly difficult to apply for both employers and auditors. Employers complained that the standards used by the investigators were confusing and applied in an inconsistent manner. For their part, DOL investigators acknowledged that applying these standards can be the most difficult part of a compliance audits. An assessment may not only involve a review of the specific tasks that are assigned to an employee but also may hinge on how an individual employee views his or her duties. For example, 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.

## Employees Say That Inflation and Oversimplification Have Undermined Regulatory Protections

From the standpoint of employees, their representatives and other experts were particularly concerned that the use of the exemptions be limited, maintaining the 40-hour workweek standard for as many employees as possible. For this to be accomplished, they were of the opinion that the regulatory tests should provide the type of protections that were originally intended. In this regard, the following two issues seemed particularly important for 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 much less meaningful.

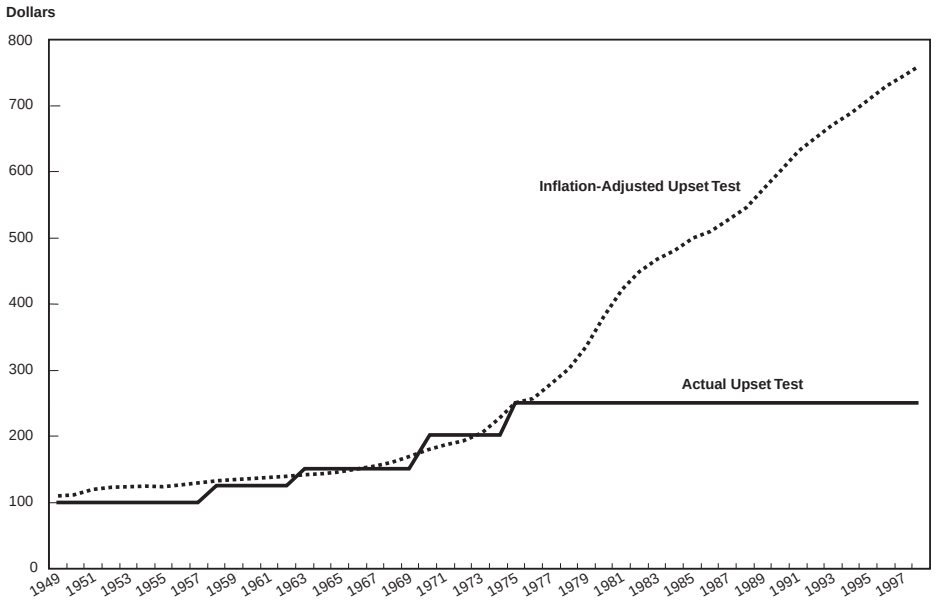
- The duties test that determines who can be classified as an exempt executive has been increasingly simplified by judicial opinions. When combined with the low salary-test levels, employees believe that few protections remain for lower income workers with supervisory responsibilities.

In the 25 years since the salary-test levels were last increased, inflation has severely eroded the protections available under the exemption regulations. To illustrate the effect of inflation on the regulations, we focused on the highest salary-test level—the so-called upset test. For example, under the regulations, a cook making more money per week than specified by the upset test would be presumed to be an exempt executive as long as he supervised two other employees and his primary

duty was management. If, however, he made less money than the upset salary level, his duties would be subject to much greater scrutiny (including the calculation of the specific amounts of time spent on routine kitchen tasks) before he would be classified as exempt.

Since 1975, the upset salary-test level has been set at $250 per week. Figure 2 shows the upset test over the period from 1949 through 1998. To be equivalent to the 1975 upset test, the test level would have to be increased to at least $757 per week.

**Figure 2: 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 20 C.F.R. chap. V, part 541; inflation-adjusted upset test calculated by GAO.

To gauge the effect of inflation, consider again the supervisory cook. Today, the upset test is applicable, and the cook is presumed to be an exempt executive as long as he makes more than $6.25 per hour, for an annual salary of $13,000. However, in 1975, when the salary test levels were last adjusted, the cook would have been presumed to be an exempt executive only if he made over $39,400 (in 1998 dollars). To put

it another way, in 1975, about 40 percent of the full-time workers would have used the highest salary level (the upset test) to determine whether they were exempt; in 1998, the upset test levels were applicable to 91 percent of the workers.

For lower-income supervisors, other factors compound the effect of the very low salary-test levels. Although the regulations specifically require that exempt administrators or professionals work in jobs that call for exercise of independent judgment and discretion, there is no such express requirement for an exempt executive. Federal court decisions have confirmed that assistant managers in fast-food restaurants can be exempt executives, even though they receive explicit instructions on how to perform their jobs as long as they supervise two or more employees and have management as their primary duty. Federal case law in the 5-year period from 1994 through 1998 included few instances in which a court overturned an employer's classification of a lower-income supervisor as an exempt executive.

Employee representatives complained that the application of the executive duties test has been oversimplified. Under the regulations, as currently interpreted, almost any employee who is assigned to supervise two or more employees in a particular department of a company can be classified as an exempt executive. According to these representatives, employers have deliberately reorganized their work places to create new levels of supervision and thus more exempt executive supervisors. Thus, where a grocery store originally had one or two store managers, it now may have many different departments—such as the meat department or the produce department—headed by exempt executives.

## 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 the 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 interests of employers and those of employees. Before any changes are made, effects on these competing interests must be carefully weighed.

Four different proposals that have been advanced illustrate some of the competing considerations affecting regulatory reform:

- Eliminate the salary-basis test—From the employer's point of view, the exacting requirements of the salary-basis test do not determine managerial or professional status, but rather impede legitimate requirements for accountability. However, DOL has found no

satisfactory substitute for the test in the 60 years since it was first introduced, and relies upon it to distinguish the bona fide executive from a clerk or technician.

- Raise the salary-test levels—Although nearly everyone we talked to—employers, employees, and experts—agreed that the current salary levels were far too low and should be increased, employer and employee groups disagreed sharply on whether the duties tests should remain the same after the salary-test levels are increased. For example, retail employers were strongly opposed to reviving the time limitations on amount of nonmanagerial work performed, while union representatives believe that time limitations are critical criteria for assessing managerial status.

- Add a category of "knowledge worker"—For employers, this would expand the exemptions to highly skilled workers who are not engaged in traditional manual labor but who follow detailed procedures to perform their job. Union representatives, however, believe that these workers are only the modern equivalent of the traditional factory workers, and that the historic limitations on work hours and requirements for overtime pay should apply to the modern workforce.

- Adjust salary levels and duties, setting an income level (a ceiling) above which all employees would be exempt—Although there is nearly universal agreement that salary levels for the tests should be raised, adding an income ceiling is much more controversial. For employers, adding an income ceiling would bring more certainty into the classification of higher paid workers—if an employee earns over a specified amount of salary, the employer could automatically treat the employee as exempt from the FLSA overtime requirements. For employees, however, a ceiling would effectively eliminate the requirement for a 40-hour work week for higher-paid workers—no worker earning over the ceiling level would be entitled to overtime pay for hours worked in excess of the 40-hour workweek.

## Conclusion

The concerns of employers and employees about the operation of the white-collar exemptions in today's work place involve all aspects of the regulations—the salary-basis test, the salary-test levels, and the duties requirements. DOL has not updated these tests in decades, and although it made some efforts to revise the regulations in the 1980s, it is reluctant to revise them because of the difficulty of getting consensus. However, given the economic changes in the 62 years since the passage of the FLSA, it is important to readjust these tests to meet the needs of the

modern work place. To avoid a piecemeal approach to reform, we recommended that the Secretary of Labor undertake a comprehensive review of the regulations and make needed adjustments to meet the needs of the modern work place

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions you or other Members of the Subcommittee may have.

## GAO Contacts and Staff Acknowledgments

For future contacts regarding this testimony, please call Cynthia M. Fagnoni at (202) 512-7215 or Nancy Peters at (202) 512-9065. Kelly Mikelson, Carol Patey, Bill Hansbury, Larry Horinko, Rich Kelley, Charlie Jeszeck, Kirsten Landeryou, Bob Crystal, Dennis Gehley, and Debra Roush also made key contributions to this testimony.

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