Working Classes

To exempt or not to exempt? That's a tricky question. Misclassifying your employees could land you in hot water, so do it right.

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From time to time, Seth Hishmeh considers changing the status of one or more of his 70 employees from non-exempt to exempt. Classifying an employee as exempt allows USAS Technologies LLC, the New York City IT consulting company he founded in 1998, to legally avoid paying employees overtime for working more than a standard workday or workweek. Reclassifying can also be a management tool. Hourly employees often consider it a promotion to join the ranks of salaried exempt workers, says the 34-year-old entrepreneur, but sometimes he prefers people whose work is billed to clients by the hour to remain nonexempt. "If they're salaried employees, sometimes they don't pay as much attention to how many hours a day they're working, or make as good use of their time," Hishmeh explains.

The decision of how to classify an employee carries significance for labor costs, employee morale and, last but not least, the chance of a visit by investigators from the Department of Labor, the federal agency charged with enforcing the Fair Labor Standards Act.

The FLSA requires overtime pay for time worked over 40 hours in a week. Though that seems simple, the many modifications and refinements made to the law since it passed in 1938 require a good deal of interpretation to understand. "You can bring five auditors into a company and get five different results," says David Lewis, president of Stamford, Connecticut, human resources consulting firm OperationsInc.

The penalties for failing to follow the regulations are more definite: retroactive payments of overtime or other wages due for up to three years in the past, plus fines. Violations are common, Lewis says, and include misclassifying inside salespeople, accounting employees and office managers as exempt employees. The DOL usually considers these workers nonexempt, no matter what you call the position. "The DOL doesn't look at somebody's title," Lewis says. "They look at the job description." Office managers, for instance, are likely to be considered nonexempt if they don't supervise two or more people.

If you are considering reclassifying employees' status, check out the FLSA website at www.dol.gov. It will give you an idea of what you're up against, but it won't explain differences in local laws. If the task seems daunting, you can hire a consultant to help you write job descriptions and plan strategy.

Fixing any mistakes you find doesn't have to be expensive. You should offer to pay employees back wages, but going forward, you can adjust hourly wages, bonuses or other compensation so the total cost to the company isn't too different. But don't assume that paying employees a bonus at the end of the year will make up for overtime you should have been paying: Investigators will simply add the bonus to the employee's compensation, increasing the amount of potential liability, Lewis warns.

If you find out you need to reclassify a job or jobs, don't wait. The longer you do, the more likely a disgruntled employee or ex-employee will report you to the DOL. And the impact of a flawed classification is greater on growing companies because every time you add some-one, you increase your potential liability. Says Lewis, "It's infinitely more painful and damaging the longer you wait."