FLSA Changes: Decision-Making Guide

This guide is the first of a two-part series we have developed to assist employers in complying with the new minimum salary threshold that applies to many white collar employees.

What do you mean by "new rule"?

The Fair Labor Standards Act requires that employees earn a minimum wage as well as overtime pay for hours worked over 40 in a week, but it also provides that employees who perform certain job duties may be exempt from these requirements. The Department of Labor (DOL) has the power to make rules that relate to these exemption categories, including what duties will qualify an employee for an exemption, and how they are paid, and how much they are paid.

The new rule affects the minimum salary required for many employees to qualify as exempt. Previously the minimum salary for all executive and administrative employees, and many professional employees, was $455 per week, or $23,660 per year. The new rule sets that minimum at $913 per week, or $47,476 per year.

The new rule also increases the minimum salary for employees who are exempt under the Highly Compensated Employee (HCE) exemption. That number went from $100,000 per year to $134,004 per year.

The new rule will become effective on December 1, 2016, meaning employers should comply by that date.

What should we do first?

We recommend that employers decide what course of action they will take for affected employees and begin to plan for how those changes will be implemented. In this guide, we will focus on the four main steps employers need to take in making decisions about what their course of action will be:

1. Identifying which exempt employees could be affected;
2. Calculating the hours worked by affected exempt employees;
3. Considering which compensation strategy is the most appropriate; and
4. Conducting a compensation analysis for each employee.

STEP 1

Identify Affected Exempt Employees

→ Identify the organization's exempt employees that are paid at or below $47,476. As a best practice, consider identifying exempt employees at or below $52,000, so wage compression can be part of your big picture evaluation.

*WHAT IS WAGE COMPRESSION?

When the salary floor for a position is increased but the ceiling is not, **wage compression** occurs for a particular positon or tier of positions. *For example*: Employee A is new to the company and making $44,000; Employee B has the same title as Employee A but has been in the position for 2 years and is making $48,000. The company elects to increase Employee A's salary to the proposed threshold, making their salary nearly equal to that of Employee B. This is wage compression, and should be avoided whenever possible so your more experienced or higher ranking employees feel they are being treated fairly.

STEP 2

Calculate Total Hours Worked by Each Employee from Step 1

In order to properly assess compensation in the upcoming steps, it's necessary to first determine an accurate number of hours worked for each employee identified in Step 1.

Why go to the trouble?

Failure to properly estimate an employee's hours worked may lead to shocking results when you reclassify them as hourly. For instance, calculating and employee's new hourly rate based on the assumption that they're working 40 hours per week could lead to a huge amount of unexpected overtime liability if the employee has actually been working more than 40 hours per week on a regular basis.

However, asking exempt employees to begin tracking hours worked without providing detailed reasoning may cause confusion. You'll want to **clearly communicate** with employees that this is for tracking and preparation purposes only and will have **no effect on their current salary.** The sole purpose is to prepare for compliance with the new laws – not micromanagement.

In order to get the information you need, you'll have to ask your exempt employees to do something new: track their time. How to go about this is up to you, but here are a few options to measure current hours worked: Ask the employees to begin tracking their hours worked. This is our preferred method, as it will likely result in the most accurate timekeeping records. You can ask employees to use the same timekeeping system as non-exempt employees, have them track their time on the computer, on a paper timecard, or even on a phone app – it's up to you.

→ Ask managers to begin tracking hours worked for their exempt employees.
→ Ask managers to estimate the number of hours worked for each of their exempt employees.
→ Utilize the standard company workweek (e.g. Monday through Friday, 8:30 am to 5:00 pm), or the standard workweek for the position in question, then estimate the number of hours worked in excess of 40 per week.

STEP 3

Evaluate the Options and Decide on Appropriate Compensation

Identify each employee's current base salary and total incentive pay (bonuses, commissions, any other incentive pay). Add these amounts to get their total annual earnings.

Compare this amount to the following pay options:

→ **Increasing the employee's pay to $47, 476.**

→ **Re-classifying the employee as hourly non-exempt and paying them at a rate determined by their current salary divided by 2,080.** This simple equation works best if the employee currently works around 40 hour per week on average.

- Calculation for hourly for rate of pay: total annual earnings ÷ 2,080 hours (40 hours per week for the full year)
- **Example:** $46,000 ÷ 2,080 = $22.12 per hour

→ **Re-classifying the employee as hourly non-exempt and calculating a cost-neutral rate of pay.** This rate of pay accounts for overtime the employee is doing currently and provides an hourly rate of pay which will result in the employee making approximately the same amount annually when paid by the hour as they did when they were on salary. This equation works best for employees who regularly work overtime.

- Calculation for cost-neutral hourly rate of pay: annual earnings ÷ (2,080 + (annual overtime hours x 1.5))
- **Example:** $46,000 ÷ (2,080 + (260 x 1.5)) = $18.62 per hour

→ **Re-classifying the employee as salaried non-exempt and paying them the same each week they work 40 hours or fewer, and overtime when they work more than 40 hours.** With this classification you may continue to pay an employee on a salary basis – meaning a fixed base amount each week - but you'll still have to pay them time and a half for hours over 40 each week. You'll need to continue to carefully track their hours to ensure they always receive overtime pay if due. If using this classification, you should use their base weekly or yearly salary to determine their overtime rate.

- Calculation for *overtime* rate of pay: total annual earnings ÷ 2,080 hours x 1.5
- **Example:** $46,000 ÷ 2,080 x 1.5 = $33.17 per hour

Salary non-exempt is a somewhat risky classification, so we recommend caution here. This pay classification requires strict timekeeping, just as for all non-exempt employees, in order to determine overtime eligibility. This includes keeping track of when these employees begin and end work each day as well as compliance with any state-mandated meal period requirements.

Consider the Big Picture

Wage compression was mentioned above, but you should also consider the effects of giving certain employees raises while others stay at the same rate of pay – even if they are in different job types. For instance, if several male employees received raises to bring their salary up to the new threshold, but a female employee who was already above the threshold did not receive a raise (or even received a pay cut to help balance the books), that could cause considerable trouble, even if only from a morale perspective.

Whenever possible, attempt to classify all employees in a particular job group or position the same way. If this can't be done, document your business reasons for the different classifications.

Also consider whether or not incentive pay will continue to be provided to employees who will not be classified as non-exempt. Providing incentive pay to non-exempt employees can complicate overtime calculations, since those incentive payments must be included in an employee's base pay when determining their overtime rate. Essentially, incentive payments will increase an employee's base pay rate and thus increase their overtime rate for that week as well. Although incentive payments can continue to be a great motivator, a little more math is required when they are provided to non-exempt employees who work overtime.

Check out the next in this two-part series, FLSA Changes: Implementation Guide, as well as our 2-Minute HR Trainings on these topics.

*INCENTIVE WHAT?

Incentive pay includes non-discretionary bonuses, commissions, and any other non-hourly pay.