FLSA Changes: Decision-Making Guide

The proposed changes to the white collar exemptions of the Fair Labor Standards Act (FLSA) are looming large in the minds of many employers. These rules, proposed in June 2015 and finalized on May 18, 2016, more than double the salary threshold for workers otherwise eligible for a white collar exemption from minimum wage and overtime requirements under the FLSA.

What do we currently know?

The final rules adopted a salary level of $47,476 per year, meaning that almost five million employees who are currently exempt from minimum wage and overtime requirements will have to be reclassified as non-exempt, or hourly, employees. The rules also have the white collar salary level (and the highly compensated employee compensation rate) automatically increase each year. These are tied either to a cost of living index or to a set percentile of earnings across all salaried workers.

What is the current status of the new rules?

The comment period for the proposed rule closed on September 4, 2015. On March 14, 2016 the Department of Labor sent the final rules to the Office of Management and Budget (OMB). **On May 18, 2016, the final rule was announced and the changes will take effect on December 1, 2016.**

What should we be doing now?

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 $50,000. Expanding the salary range consideration is beneficial for the following reasons:

→ Since the final rules include an automatic annual salary increase, you will be prepared in advance.

→ Considering the salary of employees just above the new level may allow you to avoid some of the wage compression that could occur.

*WHAT ABOUT WAGE COMPRESSION?

When the salary "floor" for a position is increased but the "ceiling" is not, **this causes wage compression** for a particular positon or tier of positions. *For example*: Employee A is new to the Company and making $45,000; Employee B has the same title as Employee A but has been in the position for 5 years and is making $55,000. The company elects to increase Employee A's salary to the proposed threshold, should Employee B receive a pay raise as well?

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.

For employees whose pay is close to $47,476, this step may not be necessary. Please review the following steps for these employees prior to calculating current hours worked.

Why go through the trouble?

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

In order to get the information we need, we'll have to ask our 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.

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.

→ 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, 8:30am to 5:00pm), or the standard workweek for the position in question, then estimate the number of hours worked in excess of 40 per week.

STEP 3

Consider Appropriate Compensation

Identify each employee's current base salary and total incentive pay (bonus, 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 non-exempt and paying them on an hourly basis 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:** $50,000 ÷ 2,080 = $24.04 per hour

→ Calculating a cost-neutral rate of pay for the employee. 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:** $50,000 ÷ (2,080 + (260 x 1.5)) = $20.24 per hour

STEP 4

Conduct a Compensation Analysis

When the new rules go into effect, employers have three options for employees who do not meet the new exempt criteria:

→ Continue to pay them on a salary basis but consider them non-exempt from overtime; you'll need to continue to track their hours and pay overtime when they work over 40 hours in a workweek.

→ Reclassify the employee as hourly non-exempt and pay an hourly wage with overtime when they work over 40 hours in a workweek. This can be accomplished using either hourly rate calculation listed in Step 2.

→ Raise their base salary to the minimum threshold of $47,476.

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 they begin and end work each day as well as compliance with any state mandated meal period requirements.

Consider whether or not incentive pay will continue to be provided. 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.

*INCENTIVE WHAT?

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