<u>Important changes to the Fair Labor Standards Act, effective December 1, 2016</u>

The federal Fair Labor Standards Act (FLSA) requires employers to pay non-exempt employees at least the minimum hourly wage for all work performed and pay time and a half for hours worked in excess of 40 hours per week. The federal FLSA applies to employers who (1) have at least two employees and an annual volume of sales or business of at least $500,000 or (2) are hospitals, businesses providing medical or nursing care, schools and preschools, and governmental agencies. The federal FLSA also covers workers who are "engaged in commerce or in the production of goods for commerce."

In response to President Obama's 2014 Presidential Memorandum directing the Department of Labor to update its regulations, on May 18, 2016, the DOL issued its Final Rule, which will take effect December 1, 2016, and makes four important changes to the exemption for Executive, Administrative, and Professional workers:

1. The standard salary level is increased to $913 per week ($47,476 annually).
2. The annual compensation requirement for "highly compensated employees" is increased to $134,000.
3. Salary and compensation levels will be automatically updated every three years.
4. Non-discretionary bonuses and incentive pay may be included to satisfy up to 10% of the standard salary level.

Because the DOL estimates that this Final Rule will potentially affect 22.5 million workers, it requires employers to take action now to prepare for the December 1, 2016, effective date.

So what's an employer to do?

<u>The first step</u> is to gather information for all employees who you have classified as non-exempt (i.e. salaried employees). Start by finding and dusting off those job descriptions, which may or may not be current. Then, meet with the supervisors of those employees to inquire whether the job descriptions are accurate or not. If the job descriptions are not accurate, then now is the time to update them to be as accurate as possible. Talk to the supervisor about each employee's day-to-day tasks, areas of responsibility, and qualifications. Talk to the employee about the same things. Once you've gathered the information, revise the job description to match (as close as reasonable) the actual job duties, responsibilities, and qualifications.

<u>The second step</u> is to analyze whether each employee meets the exemption requirements. This analysis starts with the notion that all employees are non-exempt and proceeds to a determination of whether the exceptions apply. To be exempt under the Executive, Administrative, or Professional exemptions, the employee must meet three "tests": (1) "salary basis test": the employee must be paid a predetermined and fixed salary that is not subject to reduction due to variation in the quality or quantity of work performed; (2) "salary level test": the salary received must satisfy the minimum requirements of $913 per week ($47,476 annually) or for highly-

compensated employees, at least $134,000 annually; and (3) "duties test": the employee's duties must primarily involve executive, administrative, or professional duties:

> Executive: The employee's primary duties involve the management of the enterprise or a customarily-recognized department or subdivision, the customary or regular supervision at least two full-time employees or the equivalent (i.e. part-time employees who combine for 80 hours per week), and the authority to hire and fire other employees or make recommendations that are given particular weight.
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> Administrative: The employee's primary duties involve office or non-manual work that is directly related to management or general business operations and involves the exercise of discretion and independent judgment on matters of significance.
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> Learned Professional: The employee's primary duties involve the performance of work requiring advanced knowledge, which is defined as work that is predominately intellectual in nature and requires consistent exercise of discretion and judgment. The advanced knowledge must be in a field of science or learning and be customarily acquired by a prolonged course of specialized intellectual instruction.
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> Creative Professionals: The employee's primary duties involve the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

So if you are now unsure whether your employee is exempt or not, then you're in good company with judges and attorneys who argue about the applicability of these tests to particular jobs or groups of jobs. If you are unsure, you can treat the employee as non-exempt (the FLSA does not require any employee be exempt; remember that is the exception) and/or consult an attorney if you want a legal opinion.

The third step, after the analysis is completed, evaluate the results:

> If your analysis confirms the employee is correctly characterized as exempt (including meeting the increased minimum salary level), that's great. Document the result and keep your notes for future reference. Have the employee sign off on the job description if it has been updated or if there is not a signed job description on file.
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> If your analysis reveals that the employee is incorrectly characterized as exempt instead of non-exempt, you have more work to do. If the employee meets the salary basis test and the duties test, but failed the salary level test, then you can either (1) increase the salary level to meet the statutory minimum of $913 per week, including up to 10% of non-discretionary or incentive pay into the calculation, or (2) convert the employee to non-exempt. This decision is a cost analysis of whether it will cost more to increase the employee's salary vs. pay the employee overtime for hours in excess of 40 per week.
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> If you elect to convert the employee to non-exempt, follow these 4 steps:
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> > Step #1: translate the employee's salary into an hourly wage based on the number of hours the salaried employee is actually working on average. The employee

may or may not be working 40 hours per week; so you'll need to confirm this information with the employee's supervisor. (If the employee is working less than 40 hours per week, then use 40 hours per week for this step and see the analysis for "difficult" employee in Step #3.) The following example illustrates this step. Your employee is currently earning $1,725 salary per two-week pay period. If the employee is actually working 50 hours per week, then the hourly wage translates to $17.25 per hour. If the same employee is actually working 40 hours per week, then the hourly wage translates to approximately $21.50 per hour. In the translation step, using the proper number of hours actually worked per week is key to avoiding financial shortfalls in the budget that would be caused by this employee's change from earning $1,725 per two-week pay period (salary) to now earning $2,150 per two-week pay period (hourly) if the employee works 50 hours per week and the translation to the hourly rate was based on 40 hours per week, i.e. $21.50 per hour multiplied by 100 hours.

Step #2: decide what to do about paid time off (vacation, sick, other) "PTO" benefits. If this salaried employee has not been required to account for time off work (i.e. document amount of time off used for vacation, sick, other) and/or if PTO was unlimited, now it is necessary to determine the amount of time the employee will be allowed to use as PTO and if those amounts will be categorized as vacation, sick, or other. Moving forward, this employee will need to document hours worked and hours not worked but compensated as PTO. Remember PTO is an employee benefit that you as the employer choose to provide; it's not a legal requirement.

Step #3: tell the employee. Generally, people do not like change, especially in situations in which they perceive that the change could adversely impact them. So you'll need to plan ahead for the completion of this step. Let's look at some potential scenarios:

> "Easy" employee—the salaried employee who has faithfully been working 40 hours per week and not using an unreasonable amount of time off work. After the change to hourly, this employee will be receiving the same compensation because the salaried amount has been translated into hourly using 40 hours per week, and PTO time, as decided in Step 2, will be sufficient to cover the necessary time off work. The only real change for this employee is the need to fill out a timesheet, which for the person who actually has been working the 40 hours and not taking an unreasonable amount of PTO, should not be a problem.
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> "Difficult" employee—the salaried employee who has not been working 40 hours per week or has been "coming and going" as he pleases and/or taking significant time off work. This employee will most likely be

resistant to the change because life has been good if he has only been actually working 30 hours per week but getting paid a full-time salary. After the change to hourly, this employee is faced with the options of (1) working 40 hours per week to earn the same amount as he earned as a salaried employee; (2) working 30 hours per week and rapidly using up his PTO; or (3) receiving less pay in his paycheck. Anticipate as many potential issues as possible and decide in advance what you will say if they come up. Prepare a script for the meeting, document notes of the meeting, and identify any monitoring that will be necessary moving forward.

“Average” employee—the salaried employee who has been mostly faithful to the 40 hours per week and takes moderate time off. The average employee needs assurance that he has not “done something wrong” to warrant the change. So provide the explanation that in compliance with the changes to the FLSA, a business decision has been made to change him to hourly, and if true, others are being changed, too. Also, assure him that if all goes as expected, he will see no change in his paycheck or the amount of time worked because the hourly rate has been calculated based on his salary and hours worked, and PTO has been analyzed to maintain his previous level of compensation and allow reasonable time off for vacation, sick and other events that arise.

Step #4: implement. Promptly enter changes into payroll system, provide training to employees to fill out their timesheets timely and turn them in, ensure payroll systems are functional, and document all notes to the file. Allow employees a few payperiods to get it right, but then require compliance. Don’t let all your work (and resources expended) go to waste by letting implementation slip through the cracks.

In conclusion, start now to have “all systems go” before December 1, 2016. Depending on your business’ pay periods, plan ahead so any necessary changes take effect no later than the hours worked on December 1st. Finally, mark your calendar to complete this process again in the fall of 2017 to prepare for the automatic increases anticipated to take effect January 1, 2020.