

# Changes to the FLSA Overtime Regulations – Are You Ready?

The final rule changes to the Fair Labor Standards Act (FLSA) Overtime Regulations were published on May 23, 2016, and will become effective on December 1, 2016. It is anticipated that as many as 4.2 million workers across the country may now be eligible for overtime pay within the first year of implementation. The Department of Labor (DOL) estimates that employers will spend \$592.7 million to prepare to comply with the new rule, which includes time spent becoming familiar with the current regulations and making adjustments to policies and procedures and the related managerial costs. The impact is significant and affects all industries.

## Why the Changes to FLSA?

In March 2014, President Obama issued a memorandum to the Secretary of Labor indicating that the “regulations regarding exemptions from the Act’s overtime requirement, particularly for executive, administrative, and professional employees (“EAP,” often referred to as the “white collar” exemptions) have not kept up with our modern economy. Because these regulations are outdated, millions of Americans lack the protections of overtime and even the right to the minimum wage.” President Obama then issued a Presidential Directive to “propose revisions to modernize and streamline the existing overtime regulations.”



## Overview of Rule Changes

Although the existing duties and salary basis tests for determining overtime exemption status did not change, significant changes were made to the salary level tests. These changes include:

1. The minimum salary level for an EAP position will increase from \$455 per week (\$23,660 annually) to \$913 per week (\$47,476 annually) to retain exempt, salaried status.
2. The weekly threshold for highly compensated employees will increase from \$455 to \$913 per week and from \$100,000 to \$134,004 annually.
3. A mechanism for automatically updating the salary and compensation levels every three years has been established.
4. Employers may count up to 10% of nondiscretionary bonuses, incentive payments, and/or commissions toward the required salary level as long as these are paid on a quarterly or more frequent basis.

Some of the intentions of the regulatory rule changes are to reduce the opportunity for employers to take advantage of employees under the pretext of exemption status, to increase wages, to update the overtime protections provided to employees, to address the shifting landscape of how and where people work, and to simplify the regulations to increase understanding and application of the law. However, the rule changes may have some significant unintended consequences.

- **Reduction in pay.** If employers cannot afford to increase employees’ salaries to \$47,476 to maintain overtime exemption, they may decide to implement “cost neutral” or other pay practices that may not work to the advantage of employees. Employers may change employees’ exemption status to nonexempt and then “back into” an hourly rate that takes into consideration an estimated number of hours worked in excess of 40 each workweek. This process may result in a lower hourly wage being paid to employees. In this situation, employers will be in compliance with the new regulation under the FLSA, but employees will not receive an increase in compensation and, in some situations, may experience a reduction in compensation.
- **Organizational restructure.** Employers may eliminate the mid-level tier of supervision and management to mitigate the risk of increased personnel expenses and may identify “lead” employees in nonexempt roles to assume related supervisory duties with minimal increases to employees’ regular rate of pay.
- **Decreased flexibility.** In today’s highly mobile and tech savvy environment, exempt employees are able to work anytime and anywhere, which enables employees to balance work and life. Flexibility begins to blur the lines of the workday; i.e., when does the day start, when does it end, are meal periods unpaid, and what about time spent checking and/or responding to work emails outside of the normal workday? Nonexempt employees are required by law to record all hours worked to ensure they are appropriately compensated for time “suffered or permitted to work.” Employers may choose to reduce flexibility in order to adhere to new administrative requirements.
- **Impact to employee morale.** Exemption status in many organizations is a sign of prestige. When employees lose their exemption status, there can be a sense of loss, betrayal, or embarrassment that accompanies the change in status. Employees may feel micromanaged because they are now required to record all hours worked, to be mindful of when and how they work, and to limit professional development activities because of the constraints of a 40-hour workweek, especially when an employer’s policy limits the amount of overtime that can be worked.

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- **Reduction in exempt classification status.** With the automatic update mechanism, the minimum salary level for an EAP position will increase on January 1, 2020 and every three years thereafter. This indexing may result in a significant reduction in the number of employees who will be able to maintain their exempt classification status, thereby further impacting employers and employees alike in future years.

Although the final rules do not take effect until December 1, 2016, it is important to give consideration to the changes and begin the planning process now to ensure appropriate classification of positions and payment of wages for all employees.

### **Actions to Take**

- Alert executive and senior leadership of the changes needed and the potential impact on the organization.
- Create and execute a communications strategy for managers and employees to ensure understanding of the FLSA rule changes and potential impact.
- Review all position descriptions to ensure they are an accurate representation of roles and responsibilities. Resolve any titles that may be overstated or understated.
- Apply the executive, administrative, and professional exemption duties tests to determine or verify the exemption status of each position. (See [http://www.dol.gov/whd/overtime/fs17a\\_overview.htm](http://www.dol.gov/whd/overtime/fs17a_overview.htm))
- Conduct a compensation analysis on all exempt employees to determine which positions and individuals may fail the new salary level test. Consider base and nondiscretionary bonuses separately to determine total annual cash compensation.
- Evaluate the financial impact of adjusting compensation to the new minimum salary level.
- Discuss the organization's compensation philosophy and actions to be taken to address salary compression issues that may surface as a result of adjustments to impacted positions.
- Maintain effective communications with employees to ensure they understand the changes to their compensation structure and why
- It is necessary. Anticipate employee reactions so you can best tailor your message regarding the required changes.

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