

*They're Here ...*  
**Where Are You?**  
**Overtime**

Overtime went into “overtime” this year when the Department of Labor (DOL) retooled admittedly “complex, confusing and outdated” rules. The result? The number of lower-paid workers eligible for overtime is expected to increase. However, simplified duties tests may allow more jobs to be reclassified as exempt from overtime pay. The full impact depends in part on how employers address the new rules that become law Aug. 23, 2004.

### Background on FLSA

The Fair Labor Standards Act of 1939 (FLSA) wedged government oversight between employer and employee wage agreements. The FLSA instituted child labor requirements, replaced negotiated pay with a wage minimum and required overtime pay after 44 hours worked in a week (today it's 40 hours).

Why pay overtime at all? The federal government originally introduced overtime as a carrot; a stimulant for business to hire new workers rather than pay overtime to current employees. Business saw a burdensome expense, and premium pay for overtime turned management's focus on ways to temper costs.

Smaller farms and smaller newspapers are specifically exempt from overtime regulations, as are enterprises with annual dollar volumes of business less than \$500,000 per year. Small businesses that have as their only regular employees the owner or parent, spouse, child or other member of the owner's immediate family also are specifically excluded from FLSA's enterprise coverage test. Certain federal employees, agricultural workers, the self-employed and clergy, among others, also are exempt from overtime provisions.

### Overtime Exemption — The Basics

Exemption from overtime provisions of the FLSA will continue to rely on three basic tenets:

- A **salary basis** is the “mark of the status of an exempt employee” where the employee must be paid a predetermined and fixed salary not subject to reductions due to quality or quantity of work performed. Absent a clear judgment about job duties, the salary provision is an objective reference point.
- A **salary level test**, or the weekly salary equivalent paid, must meet the minimum specified for exemption from overtime.
- A **duties test** in which the employee's duties meet the definition of exemption as an executive, administrative, learned professional, outside sales or computer employee.

The duties and salary tests are further described in the final regulations. State law will preempt the FLSA if it imposes a higher standard to preserve overtime eligibility.

#### QUICK LOOK

- ⇒ The federal government originally introduced overtime as a stimulant for business to hire new workers rather than pay overtime to current employees.
- ⇒ Exemption from overtime provisions of the FLSA will continue to rely on three basic tenets.
- ⇒ While final regulations don't go into effect until Aug. 23, employers can use the interim period to ensure classifications and practices will be compliant by the effective date. Employers should consider creating a plan to comply, review and reclassify jobs as needed.

# Overhauled

By Jim Simons, CCP, Compensation & Benefit Solutions

## Overtime Pay — The Basics

- All hours worked in excess of 40 in a workweek (seven consecutive 24-hour periods) are subject to overtime pay. (Some companies also pay overtime after eight hours worked in a day, although the practice is entirely optional.)
- Hours worked are the only hours that should be counted toward the overtime rate (i.e., if a paid, non-work day occurs in the week, count the hours worked only).
- Many employers schedule full-time workers somewhat less than 40 hours per week. For example, if an employee is normally scheduled for 37 hours, overtime pay need not commence until after the 40th hour worked.
- Overtime can be calculated at 1.5 times the hourly equivalent rate for each hour worked over 40 hours in a workweek. The “half-time” overtime pay method also is permitted when there is an understanding that the salary will be paid for whatever number of hours are worked, less than or more than 40 in a week. The hourly rate used for overtime is calculated by dividing the weekly salary by actual hours worked. For example, when 45 hours are worked and the agreement calls for a \$400 salary, earnings for the week are \$422 [ $\$400 + (\$400/45 \text{ hours}) \times 0.5 \times 5 \text{ overtime hours} = \$422.22$ ].

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## The Final Regulations — What’s New

For overall highlights of changes and additions, see “Back to Basics” on page 79.

### Pay Deductions for Cause

Current FLSA rules do not permit deductions to salary when an exempt employee is absent for a fraction of the workweek due to job-related misconduct (e.g., sexual harassment, workplace violence, etc.). The final regulations allow employers to dock pay for misconduct for a day rather than whole weeks when a shorter suspension may be appropriate.

Employers must continue to state the written policy regarding pay and misconduct. An exhaustive list is not required, but the specific violations should be applicable to all employees.

## Safe Harbor for Mistaken Pay Deductions

Borrowing a concept from Employee Retirement Income Security Act (ERISA)-qualified plans, the “safe harbor” is a new means for employers to correct mistaken deductions due to misapplication of exemption status.

The safe harbor puts possible business penalties at arm’s length if a timely and good faith effort is made to correct the mistake. The final rules use the example of an employer who docks the pay of a manager who arrives to work five hours late, not permitted if the job is bonafide exempt.

No safe harbor protection is available when the employer “willfully violates the policy by continuing to make improper deductions after receiving employee complaints.” The final rules clarify that if an employer fails to reimburse employees for any improper deductions or continues to make improper deductions after receiving employee complaints, the exemption is lost during the time period in which the improper deductions were made for all employees in the same job classification working for the same manager responsible for the actual improper deductions.

## Rules Still Require Interpretation

Salary “bright lines” of \$23,660 (the exempt threshold) and \$100,000 (the highly paid employee threshold) are helpful anchors, but judgment still will be needed to apply the duties tests. The DOL made an effort to clarify the tests as supported by new examples, but employers may still be challenged to apply the following terms.

- **“Primary duty”** of one’s job shall mean the “major emphasis on the character of the employee’s job as a whole.” The DOL advises that “major” can mean more or less than 50 percent, depending on the job’s facts and circumstances.
- **“Customarily and regularly directing the work of others”** also will require a case-by-case determination based on all the facts and circumstances. (For executive and administrative exemptions.)
- **“Directly and closely related”** tasks are those that relate to exempt duties but are “not directly and closely related ... if unrelated to exempt duties.” Ten varied examples are provided in the final rules and employers may or may not find a good fit among them.
- **“Consistent exercise of discretion and independent judgment”** where judgment is “real and substantial,” again requires employers’ judgment “in the light of all the facts involved in the particular employment situation in which the question arises.” (For administrative and professional exemptions.)
- **“Knowledge of an advanced type”** is described as “a field of science or learning customarily acquired by a prolonged

course of specialized intellectual instruction ... not attainable at the high school level [and] ... not mechanical arts.” (For professional exemption.) A prolonged course of study is not necessarily evident by a four-year degree. Final rules allow for the occasional person who is by virtue of experience and self-study a professional. Some new examples may confuse matters more: Athletic trainers are cited as positions requiring advanced knowledge (and likely to be exempt), while a licensed practical nurse is expressly nonexempt.

## Employer Impact

The DOL took pains to limit the number of newly designated nonexempts to no more than the lowest 20 percent of salaried employees, half of which (10 percent) are likely to be exempt on a duties-tested basis, according to current population surveys conducted by the Bureau of Labor Statistics (BLS). Employers will need to decide if or when the salaries of those who meet the duties test should be increased to at least \$23,660 per year.

Similarly, about 10 percent of likely exempt employees earn \$100,000 or more. Pharmacists and registered nurses are considered exempt, but typically receive overtime. Employers of these professions are not obliged (or expected) to discontinue overtime pay practices.

## What to Do Now

While final regulations don't go into effect until Aug. 23, employers can use the interim period to ensure classifications and practices will be compliant by the effective date.

Employers should consider creating a plan to comply, review and reclassify jobs as needed, remembering to:

### Review and Update

Review and update any job descriptions that may not reflect actual duties and may call exempt status into question. Any jobs that have been paid as exempt but should have been nonexempt will require a calculation and payout of any prior overtime worked. Employers should look back up to two years at hours worked and may use the rate of pay in effect for the prior period. Any interest calculation on back pay is advised.

### Determine Jobs for Reclassification

Determine jobs that must be reclassified nonexempt due to:

- **Job Title/Content:** Manual laborers or other “blue collar” and “first responders”
- **Lower Wage Earners:** Where regular wages are less than \$455 per week (\$23,660 per year). Of the lower wage earners, employers may want to determine if any should receive an increase to \$23,660 to preserve exemption from overtime.

As a cost/benefit exercise, employers may want to consider how much overtime typically occurs and if the cost of keeping employees' exempt status intact is minimal. Employees who previously were exempt may have regularly worked more than 40 hours. Employers need to consider if that practice should continue for the new nonexempt employee and weigh its related cost. Employers have several options in this regard, including:

- **Restrict Overtime Hours.** As a matter of policy or company culture, many employers discourage overtime. When employers do so, they also should assess whether critical tasks will be still be accomplished.
- **Pay Overtime.** Employees' work and nonwork time (e.g., holidays and vacations) must be recorded by the hour and kept on hand for at least two years.

### Determine Pay Adjustments, Impact of Reclassification

Determine the pay adjustments and impact of reclassification to exempt status. Employees who change from nonexempt to exempt status may have regularly worked overtime and come to rely on this premium pay. The law does not require employers to account for all previous overtime pay to determine the new exempt salary. To cause the least disruption to the employee, employers can include typical overtime paid in the exempt salary calculation. Before doing so, employers may want to consider the impact of the rate change on other exempt salaries to avoid possible salary compression issues.

For example, Employee A was nonexempt and earned \$10 per hour (\$400 per week) and typically worked five overtime hours a week for a total pay of \$475 [ $\$400 + (\$400/40 \text{ hours} \times 1.5) \times 5 \text{ overtime hours} = \$475$ ]. If the same weekly hours are expected upon reclassification to exempt status and the employer wants to minimize disruption, the exempt salary would be set to \$475 per week, as well.

### Determine 'Highly Compensated Employees'

Determine if any nonexempt job holder may be exempt as a “highly compensated employee” where:

- All qualifying income (i.e., base pay, overtime, bonuses, commissions, etc.) is expected to equal or exceed \$100,000 for the year, and
- Employee “customarily and regularly performs exempt duties” of an office of nonmanual nature.

### Reflect Your Commitment to Comply

Reflect your commitment to comply with all state and federal wage requirements:

- Keep wage notices current, posted and visible

- Establish a process for employees to lodge complaints or concerns regarding pay status
- State company compliance policy in the employee handbook
- Inform and train supervisors on final regulations.

#### Determine and Reflect Impact of Salary Changes


Determine and reflect the impact of salary changes on related salary-based benefit programs (e.g., vacation, bonus, disability, life insurance and profit sharing).

#### Do Not Wait

Mishandling overtime can be expensive and has a way of catching up to employers. The DOL's Web site shows 31,213 complaints registered against employers in 2003, all of which are directed at real or perceived misclassifications. From those 2003 figures, 342,358 employees received back wages totaling \$212,537,554. Of the cases concluded, 73 percent were initiated by a complaint. The DOL has reportedly targeted low wage industries with a history of chronic violations for audit.

If the DOL comes knocking, be transparent about your transgressions and accommodate the auditor. Bear in mind the DOL is sympathetic to workers: "We never forget that behind every enforcement statistic and legal action is a person who needs our help," according to Secretary of Labor Elaine L. Chao.

#### The Future

Can total rewards professionals expect another 29 years to pass before the next update? The DOL says such a wait is unlikely and that salary levels at the very least should be adjusted when salaries change materially or department policy dictates revisions. Employers should regard the change with the same vigilance applied to keeping all compensation programs legally compliant. 

#### ABOUT THE AUTHOR

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#### FOOTNOTES

⇒ For more information about changes to overtime rules, go to [www.worldatwork.org](http://www.worldatwork.org) and click on "Overtime Regulations" under "Issue Tracker."