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FLSA Changes: Decision-Making Guide

The U.S. Department of Labor's new rule that increases the minimum salary for many exempt employees takes effect on July 1, 2024. Make sure you're prepared.

Version 1.0 | May 2024

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 exempt employees.

The second in the series, FLSA Changes: Implementation Guide, can be found in the **Guides** section of our **Resources** tab and covers implementation of changes your organization may need to make in the wake of the final rule, including review of policies, communications, training, budgeting, and frequently asked questions.

What Do You Mean by "New Rule"?

The Fair Labor Standards Act (FLSA) requires that employees earn a minimum wage as well as overtime pay for hours worked over 40 in a week, but it also provides exemptions for employees that meet certain criteria. The U.S. 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, how they are paid, and how much they are paid.

Executive, Administrative, and Professional Employees
Under the new rule, exempt executive, administrative, and professional employees (often referred to collectively as EAP employees) must be paid at least:

- $844 per week ($43,888 per year) beginning July 1, 2024
- $1,128 per week ($58,656 per year) beginning January 1, 2025

Teachers and practicing doctors and lawyers are exempt from these minimum salary requirements under federal law but may be subject to different state minimums. School-specific minimums apply to academic administrative employees.

Computer Employees
Exempt computer employees can be paid on a salary or hourly basis. If salaried, they're considered part of the EAP group and need to make the minimums listed above. Alternatively, they can be paid at least $27.63 per hour—this hourly rate was not changed by the rule.

Highly Compensated Employees (HCE)
Employees who are exempt under the HCE exemption must be paid at least the minimums listed above on a salary basis and receive total annual compensation of at least:

- $132,964 beginning July 1, 2024
- $151,164 beginning January 1, 2025

What Should We Do First?

We recommend that employers decide on a course of action and start planning for how those changes will be implemented. In this guide, we focus on the three main steps employers need to take when deciding their course of action:

1. Identify which exempt employees could be affected
2. Calculate the hours worked by affected exempt employees
3. Evaluate the options and make a decision about how, and how much, the employee will be paid

Step 1

Identify Affected Exempt Employees

Identify your exempt employees who are paid at or below the new minimums. As a best practice, consider identifying exempt employees at or below $65,000, 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 position or tier of positions. For example: Joe is new to the company and making $56,000; Ed has the same title as Joe but has been in the position for three years and is making $59,000. The company elects to increase new-guy-Joe's salary to the new minimum so he can remain exempt, making Joe and Ed's salaries nearly equal. 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

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 an 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.

To get the information you need, you'll have to track your exempt employees' hours. 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 nonexempt 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 exempt employee.
- Use the expected workweek for the position in question to determine the number of hours worked (typically by referencing the job description or the job offer).

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 $58,656 (by January 1, 2025).**
- **Reclassifying the employee as hourly nonexempt 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 hours per week on average (2,080 hours per year).
  - Calculation for hourly for rate of pay: total annual earnings ÷ 2,080 hours
  - Example: 41,600 ÷ 2,080 = $20 per hour
- **Reclassifying the employee as hourly nonexempt 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 that 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. However, if they work *a lot* of overtime in a state with a higher than federal minimum wage, their rate could end up at or below minimum wage.
  - Calculation for cost-neutral hourly rate of pay: annual earnings ÷ (2,080 + [annual overtime hours x 1.5])
  - Example: $41,600 ÷ (2,080 + [260 x 1.5]) = $16.84 per hour
- **Reclassifying the employee as salaried nonexempt 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: $41,600 ÷ 2,080 x 1.5 = $30 per hour, for hours over 40 in a workweek

Salaried nonexempt is a somewhat risky classification, so we recommend caution here. This pay classification requires strict timekeeping, just as for all nonexempt 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), it 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 incentive pay will continue to be provided to employees who will not be classified as nonexempt. Providing incentive pay to nonexempt 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 nonexempt employees who work overtime.

Incentive *what*? Incentive pay includes nondiscretionary bonuses, commissions, and any other non-hourly pay.

Check out the next guide in this two-part series, [FLSA Changes: Implementation Guide]().