

HR COMPLIANCE OVERVIEW



Best Practices for Reclassifying Employees as Nonexempt

The Fair Labor Standards Act (FLSA) provides minimum wage and overtime pay protections to most employees. Employees generally must be classified as “nonexempt” and, therefore, be eligible for such minimum wage and overtime protections unless they meet the criteria to be classified as “exempt” from minimum wage and overtime requirements. Typically, only employees in certain positions who meet certain salary and job duties criteria set forth under the FLSA may qualify for an exemption.

Periodically, employers may be required to reclassify exempt employees as nonexempt, such as following a legal change to the exemption criteria or upon discovery that an employee is misclassified as exempt. Employers may also choose to reclassify employees as nonexempt to serve other business purposes.

Employee misclassification is a common FLSA violation. Employers who fail to classify their workforce accurately may be subject to costly and time-consuming legal challenges. Therefore, it is critical that employers ensure all employees are properly classified and take appropriate measures to reclassify exempt employees as nonexempt when necessary.

Action Steps

Employee reclassification can be complicated and, if not conducted carefully, can have negative consequences, such as exposing employers to greater litigation risks or adversely affecting employee morale. Therefore, employers reclassifying employees as nonexempt under the FLSA should familiarize themselves with the distinct requirements for nonexempt employees and ensure they are prepared to implement any necessary or recommended changes. This Compliance Overview provides best practices employers may consider when reclassifying employees.

Highlights

Reclassification Best Practices

- ☑ Identify employees to reclassify;
- ☑ Establish a timeline;
- ☑ Choose a compensation structure;
- ☑ Consider changes to employee benefits, bonuses and other incentives;
- ☑ Review and update employer policies;
- ☑ Update job descriptions and related documents;
- ☑ Address previously misclassified employees;
- ☑ Communicate changes;
- ☑ Train employees and managers; and
- ☑ Continue to monitor state and local laws.

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Overview of Employee Classifications

Background on FLSA Exemptions

The FLSA requires employers to pay employees at least the federal minimum wage for all hours worked and overtime pay—at a rate of 1.5 times their regular rate of pay—for all hours worked over 40 in a workweek. However, the FLSA provides several exemptions from the minimum wage and overtime pay requirements, the most common of which are the “white-collar” exemptions, which generally apply to employees in executive, administrative, professional, outside sales and computer-related occupations and certain highly compensated employees. To qualify for most white-collar exemptions, an employee must satisfy the following tests:

- The **salary basis** test requires that the employee is paid a predetermined and fixed salary that does not fluctuate based on the quality or quantity of work;
- The **salary-level test** requires that the employee meets a minimum specified amount to qualify for the exemption. However, outside sales personnel and certain other professions, including doctors, lawyers and teachers, are not subject to the salary level test; and
- The **duties test** requires that an employee’s actual work responsibilities match the description the FLSA assigns to the exemption. Highly compensated employees are subject to a less restrictive duties test.

Reasons to Reclassify Exempt Employees as Nonexempt

Employers may be required to reclassify exempt employees as nonexempt, typically for either of the following reasons:

- Changes in the legal standards to qualify for an exemption (e.g., a change in the salary threshold or duties test); or
- The discovery that exempt employees have been misclassified (e.g., discovery during an employer audit that certain exempt positions do not meet the federal, state or local salary threshold or that an employee’s actual work duties do not satisfy the duties test).

However, employers may reclassify employees as nonexempt for any other reason or no reason at all. Importantly, employers can always classify employees as nonexempt even if they qualify for an overtime exemption. Employers may choose to do this for a variety of reasons, including:

- To minimize risk with respect to employees who border the minimum salary threshold:
 - In general, employees who earn salaries that only slightly exceed the threshold to qualify for an exemption are more likely to be misclassified (e.g., lower salaries are less likely to correspond with job responsibilities that match the description the FLSA assigns to an exemption). Therefore, such positions are more heavily scrutinized by plaintiffs’ lawyers and administrative agencies. To mitigate the risk of such scrutiny, some employers elect to reclassify positions that earn salaries at the lower end of the threshold; or
- To maintain consistency in position classifications across jurisdictions:
 - Some states or municipalities impose stricter standards to qualify for an exemption. As a result, an employee in one state may qualify for an exemption, while an employee in another state with the same job title, duties and salary may not. Employers may wish to classify both positions as nonexempt for consistency.



Employer Best Practices for Reclassification

Identify Employees to Reclassify

Employers will first need to identify which employees to reclassify as nonexempt. Initially, employers should determine which exempt employees fall below the minimum salary threshold or will fall below such threshold following a change in the law and which employees do not satisfy the duties requirements for the applicable exemption or will not satisfy the duties requirements following a change in the law. If employers do not either raise salaries or change job duties, these employees must be reclassified as exempt.

In addition to the employees that the employer is required to reclassify, employers may also choose to reclassify employees as nonexempt even though they qualify for an exemption under the FLSA. In identifying employees to be reclassified, employers may choose to assign the same classification to employees with the same job title and duties. Positions for which some employees are classified as exempt and others are classified as nonexempt are often subject to heightened scrutiny for potential misclassification. Therefore, consistent classification across positions can reduce the likelihood of legal challenges.

Establish a Timeline for Reclassification

The reclassification process can be complicated and time-consuming. In addition to any legal compliance deadline, such as the effective date of an increase in the minimum salary threshold, employers should consider the time needed to address key issues when establishing a timeline for reclassification. Important steps include:

- Identifying which employees the employer is required to or chooses to reclassify;
- Determining the appropriate compensation structure for reclassified employees;
- Reviewing and updating relevant employer policies, procedures and job descriptions;
- Evaluating changes to benefits and compensation policies;
- Establishing an approach for previously misclassified employees, if applicable;
- Communicating changes to employees, managers and payroll; and
- Training all relevant parties.

In addition to the factors above, employers may wish to implement the change in status on a natural transition date to ensure a smooth process for employees and payroll, such as at the beginning of the fiscal year or the start of a new payroll cycle.

Choose a Compensation Structure

Hourly, Salary or Other Pay Basis

Almost all employees are paid on either a fixed salary basis or on an hourly basis. To qualify for the most common FLSA exemptions, employees are required to be paid on a salary basis. When reclassifying exempt employees as nonexempt, employers will need to decide whether to continue paying such employees on a salary basis or whether to begin paying them on an hourly basis. Generally, paying nonexempt employees hourly simplifies the process of calculating overtime pay and ensures employees are paid only for hours worked. However, some employees may view salaried positions as more prestigious and value the predictability of earning a salary that does not fluctuate between paychecks. Employers who continue paying reclassified employees on a salary basis should ensure the employee's effective hourly rate is at least

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equal to the minimum wage, that employees understand the number of hours the salary covers, and that all working time is tracked and paid.

Less commonly, employers may pay nonexempt employees on a day rate or piece rate (e.g., payment based on the number of completed projects) basis. Employers using these methods must similarly ensure that the employee's effective hourly rate is still at least equal to the minimum wage and that hours are accurately tracked and paid.

Standard or Fluctuating Workweek

The FLSA requires employers to establish a workweek that starts on any day at any time to calculate standard hours worked and overtime. For consistency, employers typically apply the same workweek for all nonexempt employees but are not required to do so. If employees generally work consistent hours each week, employers calculate overtime based on a **standard 40-hour workweek**.

However, for employees with greater variation in weekly hours worked, employers may instead choose to apply a **"fluctuating workweek method."** Under this method, nonexempt employees must be paid a fixed salary that covers all hours worked each workweek (regardless of the hours actually worked). Employers must still pay employees overtime equal to 1.5 times the employee's regular rate of pay for hours worked in excess of 40 in a workweek. However, under the fluctuating workweek method, the regular rate of pay is calculated by dividing an employee's total weekly compensation by all hours worked in a given week (including overtime hours). This generally results in a smaller overtime premium than under the standard method. In preparing for reclassification, employers may consider which approach would be most cost-effective. However, certain states and municipalities prohibit the fluctuating workweek method, so employers should ensure such an approach is valid in applicable jurisdictions.

Consider Changes to Benefits, Bonuses and Other Incentives

Employers may also review existing policies that differentiate between exempt and nonexempt workers and consider potential implications for reclassified employees. For example, employers may offer different vacation policies or bonus opportunities depending on an employee's exempt status. To the extent reclassified employees may lose benefits, bonuses or other incentive eligibility, employers may consider modifying eligibility requirements to allow reclassified employees to retain eligibility. However, in making such a determination, employers should note that all nondiscretionary compensation (e.g., nondiscretionary bonuses) must be included in an employee's regular rate of pay, which is used to calculate overtime payments.

Review and Update Employer Policies

Overtime

Employers who want to limit the amount of overtime worked by reclassified employees should consider a policy of requiring overtime hours to be approved in advance and disciplining employees who violate this policy (employers are still required to pay for all overtime work even if not preapproved). However, employees who regularly work more than 40 hours per week as exempt employees may not be able to accomplish as much work if they are limited to working a maximum of 40 hours per week after reclassification. Therefore, employers who choose to restrict overtime may also consider whether to modify performance expectations, shift duties or responsibilities, or hire additional workers.

Timekeeping

Employers may consider how existing timekeeping practices will apply to any newly nonexempt employees and whether any modifications are required. For example, if employers reclassify remote or hybrid workers as nonexempt, employers

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need to ensure that such workers will be able to record time remotely. Employers should also confirm that reclassified employees and their managers have access to the organization's timekeeping system.

Remote Work

In some cases, reclassified employees may have frequently worked from home or after hours when they were exempt. However, remote or evening and weekend work is more difficult to accurately track than work performed at the office during business hours. Therefore, employers may need to establish additional guardrails for work performed at irregular times or off-site by reclassified employees. For example, if reclassified employees conduct work remotely outside of business hours (e.g., answering emails during evenings or weekends), employers may need to modify their policies to ensure that such time is properly recorded or require all work to be conducted during business hours.

Meal and Rest Breaks

Although the FLSA does not require meal periods or rest breaks, many employers have policies that provide meal and rest breaks to nonexempt employees, and many states and municipalities have laws that require employers to provide such breaks. Employers may wish to review these policies to assess whether they are practical as applied to newly reclassified employees or whether any modifications are necessary.

Update Job Descriptions and Related Documents

Employers should review and update internal and external documents to indicate the change in classification for applicable positions. For example, employers may need to update job descriptions, performance evaluation forms, offer letters and job postings to reflect the new nonexempt classification. Employers may also use this opportunity to conduct an audit of job descriptions to ensure they accurately reflect employee job duties.

Communicate Changes in Advance

Employers should communicate the change with employees in advance of the date reclassification takes effect. The communications might include an explanation of the change in employee classification, the date such change goes into effect, a description of the organization's timekeeping policies (and meal and rest break policies, if applicable), the employees' obligations under such policies, and a description of any changes under employer policies that differentiate between exempt and nonexempt employees (e.g., vacation policies). Some employees could view the reclassification as nonexempt as a demotion, so employers may want to reassure employees that the change has no effect on their position and emphasize the positive aspects of reclassification, such as overtime eligibility.

Employers should also notify managers of the new requirements so that they understand their obligations with respect to newly nonexempt employees, such as reviewing and authorizing overtime. Employers may also consider notifying payroll personnel of any potential changes to employee paychecks, such as paying and calculating overtime and converting salaried employees to hourly employees.

Address Previously Misclassified Employees

In some cases, employers are required to reclassify exempt employees upon discovering that such employees did not meet the requirements to qualify for an exemption. Employers who misclassify employees may be subject to claims for substantial penalties, including unpaid overtime, civil fines, and other damages, generally for a period of either two or three years.

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Employers should note that corrective measures do not necessarily shield them from future claims, as the FLSA generally prohibits private settlements. Given the potential financial risk, employers who have misclassified employees should engage legal counsel to evaluate their corrective options.

Train Employees and Managers

Previously exempt employees may be unfamiliar with timekeeping and other practices applicable to only nonexempt employees. Therefore, in addition to communicating the change, employers may consider training reclassified employees on timekeeping, hours scheduling, overtime approval, meal and rest breaks, and any other policies applicable only to nonexempt employees prior to the effective date of their reclassification. Managers of the reclassified employees may also need additional training to understand their obligations with respect to such employees, such as approving or denying overtime and ensuring hours are accurately tracked and reported.

Review and Update Recordkeeping Procedures

The FLSA imposes certain recordkeeping requirements for nonexempt employees. Under the FLSA, employers are generally required to maintain records of nonexempt employee identifying information, payroll data, hours worked and wages earned for three years. Employers should review existing recordkeeping practices and ensure compliance with their recordkeeping obligations for reclassified employees.

Review State and Local Laws

Some employers may be subject to state or local laws that impose different criteria to qualify for an overtime exemption. Therefore, employers should always evaluate proper employee classifications using applicable state and local criteria as well as federal criteria. Additionally, certain state and local laws, including those regarding meal and rest breaks, may only apply to nonexempt employees. Employers who reclassify employees as nonexempt should determine whether any such state or local wage and hour laws may apply to the reclassified employees and, if so, should inform the employees of these additional rights and benefits.