

WHAT YOUR NONPROFIT NEEDS TO KNOW ABOUT THE NEW OVERTIME RULES

A GUIDE FOR KENTUCKY NONPROFIT NETWORK MEMBERS

On May 18, the U.S. Labor Department (DOL) announced [final overtime regulations](#) (warning: the linked regulation is 508 pages) that specify that most white-collar employees earning less than \$47,476 per year will be entitled to overtime compensation, regardless of whether they are currently classified as overtime-exempt executive, administrative, or professional workers. The new overtime rules take effect on December 1, 2016. While there are ongoing efforts to overturn the new regulations, exempt nonprofits, and/or delay the effective date, we strongly encourage your nonprofit to be prepared and compliant by the December 1 deadline.

Nonprofits employ one in nine Kentuckians, and many are likely to be affected by the new rules. Kentucky Nonprofit Network is providing this information to highlight key details about the DOL overtime rules and how they will apply to nonprofits.

What is the current law?

The Fair Labor Standards Act (FLSA) is a federal law that provides that employees – except for those who are specifically exempt – are required to:

1. Be paid at least the federal minimum wage (currently \$7.25 per hour – may be higher in some Kentucky cities); and
2. Receive overtime pay at one-and-one-half times their regular rate of pay for all time worked in excess of 40 hours in any work week.

Many nonprofit employees are exempt from FLSA's overtime pay requirement if they:

1. Are paid at least the **minimum salary level** provided under the DOL regulations;
2. Are paid on a **salary basis**; and
3. Exercise **job duties** that are classified as exempt under FLSA.

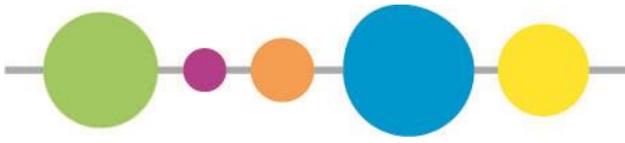
Four of the most common FLSA overtime exemptions include:

- **Executive** employees who are paid a salary of at least \$455 per week (\$23,660 per year), whose main duty is management of a large part of the nonprofit's operations and who regularly supervise at least two other employees. For more on the executive exemption, see this [DOL fact sheet](#).
- **Professional** employees who are paid a salary of at least \$455 per week (\$23,660 per year) and whose jobs are based on recognized professional knowledge (such as attorneys, CPAs, doctors, registered nurses, some social workers, and creative professionals). For more on the professional exemption, see this [DOL fact sheet](#).

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- **Administrative** employees who are paid a salary of at least \$455 per week (\$23,660 per year) and whose primary duties are non-manual work that include the exercise of discretion and independent judgment. For more on the administrative exemption, see this [DOL fact sheet](#).
- **Highly compensated** employees with salaries of at least \$100,000 per year, who regularly perform at least some of the job duties of an executive, professional, or administrative employee.

How do the new DOL regulations affect these exemptions?

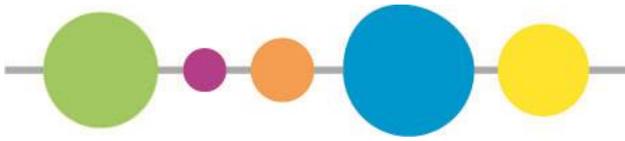
The DOL regulations make several major changes to these rules. They include:

- **Salary level threshold:** The new regulations raise the standard minimum level for salaried, exempt executive, administrative, and professional exempt workers from \$455 per week (\$23,660 per year) to \$913 per week (\$47,476 per year). The new level is pegged to the 40th percentile of weekly earnings for full-time salaried workers from the lowest wage Census Region in the country (currently the South). The final rule also raises the compensation level for **highly compensated employees** (subject to less-detailed duties tests) from its previous amount of \$100,000 to \$134,004 annually. That rate was established to match the 90th percentile of annual earnings of full-time salaried workers nationally. *Note that the salary threshold doesn't apply to teachers, lawyers, and doctors who benefit from special professional exemptions.*
- **Duties test:** It is important to remember that "white-collar" employees (i.e. executive, administrative, and professional) can be exempt from the overtime requirements of the FLSA only if their jobs meet the respective duties tests. In addition to receiving a salary at or above the new thresholds, each exempted employee must still also exercise the **job duties** of at least one of those categories and be paid on a **salaried basis**. *The final DOL regulations make no changes to the duties test.*
- **Automatic increases:** The final rule establishes a mechanism for automatically updating the salary and compensation levels a few percentage points every three years, with the first update to take place in 2020.
- **Delayed enforcement for some Medicaid-funded service providers:** Shortly after releasing the final regulations, DOL [announced](#) that it will not enforce the higher salary thresholds until March 17, 2019 for providers of Medicaid-funded services for individuals with intellectual disabilities in residential homes and facilities with 15 or fewer beds. This means that a few nonprofits will have an additional 28-month grace period before having to pay overtime for affected employees.
- **Penalties:** After releasing the final regulations, DOL increased the penalties for willful violation of the overtime rule to \$1,894 per violation (up from \$1,100 per violation). The increased penalties are effective on August 1, 2016. Nonprofits that fail to pay overtime to nonexempt employees may also be subject to state penalties and **civil litigation**. Litigation damages include back wages owed, an additional amount equal to the back wages owed as liquidated damages, and the prevailing plaintiff's attorney fees.

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Does federal or state law apply to your nonprofit's employees?

(Spoiler alert: The answer is "yes," but feel free to read through this full answer to understand why.)

In response to nonprofits' concerns about the proposed overtime regulations, DOL issued [guidance for nonprofits](#) that highlights how the overtime rules will affect nonprofit organizations. In this guidance, DOL notes that nonprofit employees are only covered by FLSA if they meet one of two coverage tests:

1. Through **enterprise coverage**, which applies to every employee of a nonprofit hospital, an organization that provides medical or nursing care for residents, a school, or a preschool (all of these are specifically mentioned in the statute) or any other nonprofit with annual commercial sales of \$500,000 or more. Most nonprofit activities probably wouldn't be considered "commercial sales," meaning that many nonprofits don't have enough commercial sales to be enterprises whose employees are all covered by FLSA.
2. Through **individual coverage**, which applies to any individual employee whose regular job functions include transactions in interstate commerce. The term "interstate commerce" is very broad, and includes things like sending and receiving mail, making out-of-state phone calls, and processing credit cards.

Kentucky has its own separate wage and hour laws that closely track, but do not automatically mirror, the provisions of the FLSA. Kentucky regulations currently include a minimum salary amount of \$455 per week for the executive, administrative, and professional exemptions; there is no current plan to increase this amount, but it is likely that, over time, this state minimum salary regulation will be changed to be consistent with the new federal minimum salary standard. While there is, for the time being, a "gap" between Kentucky law and federal law on this point, the scope of the federal FLSA is very, very broad – so nonprofits should not count on this loophole.

Translation: ALL Kentucky nonprofits need to be preparing for the changes in overtime rules by December 1, 2016.

How do nonprofits go about re-evaluating their employees' status to determine if they are exempt or nonexempt from overtime?

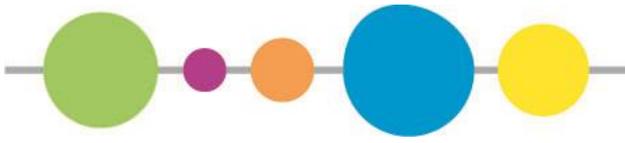
The law is meant to require employers to pay overtime for all hours worked in excess of 40, unless the employee is exempt. But the salary basis is only half of the equation. An individual has to be paid on a salary basis to be exempt, but must also have exempt duties. This requires a close and careful comparison between the actual job duties of each employee and the "duties test" for a particular exemption.

There a number of exemptions, most of which would not apply to a given nonprofit. But the ones that would apply are what we call the "white-collar" exemptions. The white-collar exemptions are "executive," "administrative," and "professional." Executive is merely an employee who supervises two or more employees and exercises typical supervisory authority, such as discipline, directing the work, doing performance evaluations... things like that. You may think administrative assistants, because they have "administrative" in their title, is exempt as an administrative employee. Nothing could be further from the truth. To be exempt as an administrative employee, you have to do office or non-manual work, related to

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the management or business operations of the company. And you have to be able to exercise discretion with respect to matters of significance. That means you've got to have some independent decision making authority where it matters to be exempt as an administrative employee. That is not typically an administrative assistant. Employers should read the regulations carefully and may need to consult with counsel to determine exempt status.

The burden of proving exempt status is on the employer, not the employee. The courts say that the exemption must be narrowly construed in favor of coverage of the act. So the employee has to (A) perform exempt duties and (B) be paid on a salary basis. And, of course, we know the salary basis also has a minimum salary component.

Translation: Now is the time to review all of your organization's employees to determine who does/does not pass the duties test. And it's important not to assume that if someone was exempt before, he or she is exempt now – while the duties test hasn't changed, it's very possible you could be interpreting it wrongly. Now is the time to find out.

Is it still possible for employers to pay nonexempt staff a salary?

An employer can pay nonexempt employees on a salary basis. But the employer still has to keep accurate records of all time worked by that employee, and doing this may negate the administrative benefits of having an exempt employee. Moreover, if that "salaried nonexempt" employee works more than 40 hours in a work week, he or she is entitled to overtime pay – even though he or she has been paid on a salary basis for the first 40 hours.

What are some options for nonprofits to comply with the overtime rules without going (too far) over budget?

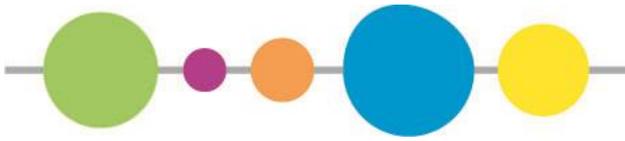
Some KNN members have shared the steps they are considering (or have already implemented) to adapt to these changes. What a nonprofit can do and what it should do are two separate questions to be weighed based on the organization's finances, mission, contractual obligations, and other factors. Here are some of the solutions (**many of them are far less than ideal**) that nonprofits have identified:

1. **Raise employees' salaries so they remain exempt.** One solution for some nonprofits is to raise (currently) exempt employees' wages so their salaries are higher than the new threshold. This makes the most sense for employees whose current salaries are only slightly lower than the new threshold (e.g., employees with salaries of \$45,000 per year). Nonprofits should note, however, that the salary threshold will be adjusted every three years, so they will need to continue to raise their employees' wages or they will face the same issues again in 2020 (and in 2023, and in 2026 . . .). This option may not be feasible (at least in the short-term) for nonprofits with workers whose salaries are significantly lower than the new threshold of \$47,476 per year.

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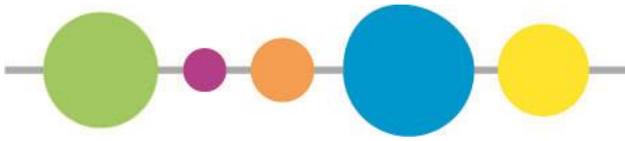
2. **Pay overtime to employees above a salary.** Nonexempt workers can still be paid on a salary basis rather than an hourly basis. This means that these employees would be paid the same amount whether they work a full 40 hours or less in a workweek. However, if salaried, nonexempt employees work more than 40 hours in a workweek, they are still entitled to time-and-half pay for all hours worked in excess of 40 hours in the week. One advantage of this option is that workers may be less likely to feel like their reclassification to nonexempt is a “demotion” if they are still paid on a salary basis; however, they still must track hours worked.
3. **Consider using the fluctuating workweek method of overtime payment.** *Warning: This paragraph (like the fluctuating workweek method itself) is confusing; you may need to read it more than once to understand it!* The “fluctuating workweek” method, which is permitted under [DOL regulations](#), allows employers to pay nonexempt employees on a salary basis for hours that fluctuate from week to week with the mutual understanding that the fixed salary is the compensation for hours worked each week (not including extra overtime compensation). **Employers that use the fluctuating workweek method only need to pay half of the regular hourly rate of pay for that workweek (rather than time-and-a-half) for hours worked in excess of 40 hours in a workweek.** By paying half-time rather than time-and-a-half for overtime, employers may be able to reduce overall salary expenses. Nonprofits considering this method should:
 - Be certain that the agreed-upon salary is at least the minimum wage of \$7.25 per hour, even in the weeks when the employee will be working the longest hours;
 - Recognize that employees’ weekly rate of pay (and the amount of additional half-time overtime pay) will fluctuate from week to week, since it is calculated by dividing the weekly salary by the number of hours worked in any particular workweek;
 - Have a written agreement in place with any employees being paid under the fluctuating workweek method to be certain that both your nonprofit and the employee understand and agree to this payment arrangement; and
 - Read the [DOL regulation on the fluctuating workweek method](#). The second paragraph includes a good example of how this method actually works.

| Hours/Week | Overtime Hours | Annual Salary | Weekly | Hourly Rate | Overtime Half Rate | Overtime Amount under Flexible OT | Total w/ Flexible OT | Overtime Amount under Standard OT * | Total w/ Standard OT |
|------------|----------------|---------------|----------|-------------|--------------------|-----------------------------------|----------------------|-------------------------------------|----------------------|
| 30 | | \$35,000 | \$673.08 | \$22.44 | \$11.22 | \$0.00 | \$673.08 | \$0.00 | \$673.08 |
| 32.5 | | \$35,000 | \$673.08 | \$20.71 | \$10.36 | \$0.00 | \$673.08 | \$0.00 | \$673.08 |
| 35 | | \$35,000 | \$673.08 | \$19.23 | \$9.62 | \$0.00 | \$673.08 | \$0.00 | \$673.08 |
| 37.5 | | \$35,000 | \$673.08 | \$17.95 | \$8.97 | \$0.00 | \$673.08 | \$0.00 | \$673.08 |
| 40 | | \$35,000 | \$673.08 | \$16.83 | \$8.41 | \$0.00 | \$673.08 | \$0.00 | \$673.08 |
| 42.5 | 2.5 | \$35,000 | \$673.08 | \$15.84 | \$7.92 | \$19.80 | \$692.87 | \$63.10 | \$736.18 |
| 45 | 5 | \$35,000 | \$673.08 | \$14.96 | \$7.48 | \$37.39 | \$710.47 | \$126.20 | \$799.28 |
| 47.5 | 7.5 | \$35,000 | \$673.08 | \$14.17 | \$7.09 | \$53.14 | \$726.21 | \$189.30 | \$862.38 |
| 50 | 10 | \$35,000 | \$673.08 | \$13.46 | \$6.73 | \$67.31 | \$740.38 | \$252.40 | \$925.48 |

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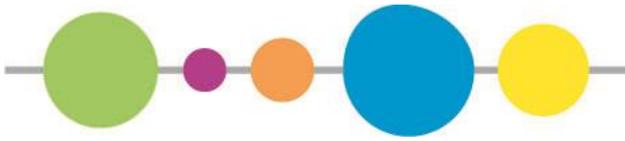


4. **Reorganize workloads or adjust schedules.** One way that some nonprofits can mitigate the costs of complying with the new rules is by shifting job functions among employees. For example, if one member of your administrative staff typically works 50 hours in a week, whereas a development staffer typically needs about 30 hours in a week to complete his or her job (spending another 10 hours during the work day making personal phone calls or checking personal social media), it might make sense to shift some job responsibilities from the administrative employee to the development staffer so that they both have about 40 hours of work to do in a week. (Note: We realize that real-world situations are rarely as clean and simple as this hypothetical example.) (Also note: This article was written in July 2016; the Pokémon Go reference may be woefully outdated by the time you are reading this!)
5. **Adjust employees' wages so you are paying approximately the same total compensation after the rule changes.** Yes, this means reducing the salaries of employees who will be reclassified as nonexempt, but paying them time-and-a-half their salary for the hours they work in excess of 40 hours per week. One way this can be done is to set a lower base hourly wage rate that takes into account a certain number of time-and-a-half hours each week for individuals who typically work overtime; the result is that they can receive the same pay based on a lower official wage rate. The upside of this is that it maintains labor costs at close to their current level. The downside of this option is that salary decreases tend to have a negative effect on employee morale.
6. **Limit the number of hours nonexempt staff can work.** For some nonprofits, it may make sense to establish policies that nonexempt staff may only work 40 hours per week or must receive approval from their supervisors to regularly work overtime. This option may help improve employees' awareness of how they spend their time and can lead to increases in efficiency and productivity. However, it may not be appropriate for some types of program staff, such as emergency service providers, residential care providers, and case workers working with nonprofit clients such as adoptive families or victims of domestic violence.
7. **Consider changing how you define your workweek.** Under state and federal law, nonprofits can define their workweek as any period of seven consecutive days. For some nonprofits with programs and events on Fridays and weekends, it may make sense to adopt a Wednesday through Tuesday workweek so nonexempt employees can take extra time off on Mondays and Tuesdays to avoid working more than 40 hours in a workweek. (Perhaps begin Friday at 12:01 a.m. through Thursday at midnight.)
8. **Recognize that overtime is only required when nonexempt employees work more than 40 hours in a week.** Some nonprofits have 35-hour or 37.5-hour workweeks. These nonprofits are not required to pay time-and-a-half for employees who are working "overtime" (e.g., 36+ or 38+ hours per week) but who have not exceeded 40 hours in a workweek.
9. **Make lunch breaks unpaid.** Some nonprofits allow nonexempt staff to count their lunch breaks as working hours. By making lunch breaks uncompensated time, nonprofits may be able to increase the total productive working time that employees can provide within a 40-hour workweek.
10. **Expect exempt staff to work more.** The reality is that the most cost-efficient, short-term solution for some nonprofits may be to shift some additional job functions to the executive director or other exempt staff who are paid \$47,476 per year or more. If nonprofits are considering this option, it is important to be certain that these staff members still meet one of the duties tests to qualify as exempt employees.

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11. **Replace some full-time workers with part-time staff or contractors.** Typically, part-time employees don't receive overtime pay since they rarely work more than 40 hours in a week. By shifting more work to part-time employees, nonprofits may be able to reduce overall labor costs. Also, the FLSA does not apply to independent contractors, so nonprofits may want to consider outsourcing some of their work to contractors. Note, however, that it is important for nonprofits to be careful not to misclassify true employees as independent contractors, since the IRS, DOL, and the Commonwealth of Kentucky actively enforce worker misclassification claims. Last summer, DOL issued an [Administrator's Interpretation](#) that explains the standards for determining whether a worker is an independent contractor.
12. **Limit telecommuting.** Employees often work longer hours (often without realizing it) when they work from home or use their mobile devices for work-related email, phone calls, social media, and texting. Some nonprofits may wish to revisit their telecommuting policies if more of their employees will be nonexempt under the new overtime rules. Limiting the ability of employees to work remotely can help minimize inadvertent overtime, but can also have negative consequences for employee morale (more time away from home), employee productivity (more distractions in the office), and the environment (more time commuting). **Tip on after-hours emails: Stop sending emails after hours to nonexempt employees. The time they spend reading and responding counts as compensable time. And if you can't help it, at least encourage recipients to wait until work time to take action.**
13. **Reduce employee benefits.** With diminishing revenue and rising costs, many nonprofits have already been forced to cut employee benefits like health insurance and retirement savings. Unfortunately, further reducing employee benefits may be a short-term way that nonprofits can comply with the overtime rules without adding to overall labor costs. Since shifting employees from exempt to nonexempt may impact the level of benefits they receive, consider re-evaluating all employee benefits to ensure fairness.
14. **Eliminate or reduce some programs or services.** This is obviously one of the least desirable options for nonprofits. However, if a particular program or service requires staff to work long hours (and receive overtime pay for much of this work) without adequate compensation from private or governmental funders, your nonprofit may need to make hard choices about whether it makes sense to reduce service levels or eliminate the program altogether.
15. **Eliminate some fundraising events.** That's right, for some nonprofits, it might make (counterintuitive) financial sense to cut back on revenue-raising activities. If staff typically work long hours on fundraising events, nonprofits may want to consider whether these events will bring in sufficient revenue to justify the additional labor costs.

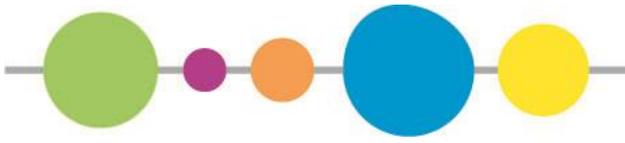
How have Kentucky nonprofits reacted to the DOL overtime rules?

[DOL's summary of the new overtime rules](#) explains that the intent of the rule change is to raise wages and/or reduce working hours for an estimated 4.2 million Americans. According to "[The Nonprofit Overtime Implementation Conundrum](#)," a new report from the National Council of Nonprofits: "Generally, nonprofits have been expressing moral support for the policy of raising the minimum salary level of white-collar employees, but experiencing operational anxiety in trying to figure out how to pay the new required additional costs in very tight, or even declining, revenue environments while providing the same level of services."

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Feedback from KNN members confirms that Kentucky nonprofits generally share this “moral support” and “operational anxiety.” Many nonprofits have told KNN that they would like to offer higher wages to their employees and that they recognize that the DOL overtime rules are intended to help many of the working families that are served by charitable nonprofits. However, the short-term reality is that new rules will mean increased personnel costs for most Kentucky nonprofits. *Unless private and governmental funders will provide immediate support for these new labor costs, nonprofits will need to make some hard operational choices in the next few months.*

What are the public policy options to address this issue?

In [“The Nonprofit Overtime Implementation Conundrum,”](#) the National Council of Nonprofits highlights two systemic solutions that would help minimize nonprofits’ “operational anxiety” as a result of the new overtime rules:

1. ***A government-nonprofit grant/contract reopener.*** About one-third of overall revenue for the nonprofit sectors comes from government grants and contracts. Many nonprofits that provide public services on behalf of governments pursuant to grants and contracts are already underpaid for the actual costs of their work. The increased labor costs of complying with the DOL overtime rules will only exacerbate this problem. The National Council of Nonprofits notes that: “Nonprofits need ways to reopen or renegotiate existing government grants and contracts either to receive reimbursement rates that incorporate the increased costs or that adjust performance obligations. Since the new costs are the result of changes to federal law, it is appropriate for the federal government to give direction to government program officers at the federal, state, tribal, and local levels on how to revise existing grants and contracts to ensure that nonprofits are treated fairly by being made whole or put in no worse position.”
2. ***Short-term transition support.*** If private funders – including foundations, individuals, and businesses – expect nonprofits to comply with labor laws (meaning they will have additional operating costs) without cutting programs and services, it is imperative that they provide immediate additional financial resources to nonprofits to maintain their current operations and service levels and to ensure compliance with wage and hour laws.

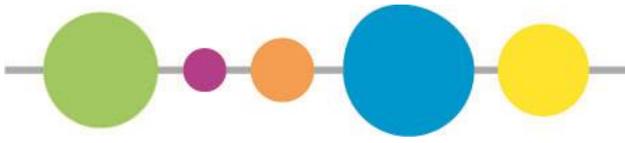
What should my nonprofit do now?

1. ***Don’t panic!*** You still have time before December 1, 2016, to make necessary changes to your nonprofit’s operations. Get started!
2. ***Do your math homework.*** Determine which of your currently exempt employees are paid a salary below the \$47,476 threshold. Ask employees to track or estimate how many hours per week they are currently working. (To avoid singling out some employees with lower salaries, you may want to consider asking all employees to track or estimate their time.) Use this information to assess what your nonprofits’ compliance costs will be.
3. ***Determine the best option(s) for your nonprofit.*** Figure out which of the compliance options described above (or which combination of these options) is the best path forward for your organization. Or come up with other creative solutions. Consult with your board of directors.

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4. **Be transparent with your staff.** Explain to any affected employees the reasons for changes in their classification, pay, or work hours. Be sure any changes are documented in writing to affected employees to ensure understanding of responsibilities relative to timekeeping, changes in pay, policies, etc. Be consistent in communicating with all staff about the changes.
5. **Make any necessary changes to your personnel policies.** These policies might include a policy requiring advanced approval to work overtime, answering emails and/or texts after hours, timekeeping, travel, no working off the clock, and more. And don't forget to share your updated policies with all employees.
6. **Talk with your funders.** Investigate whether any government agencies that provide funding to your nonprofit through grants and contracts are willing to reopen these agreements to increase reimbursement rates or adjust performance expectations. See whether your private funders would be willing to provide temporary emergency support for the additional costs of maintaining your programs and services while staying in compliance with these new rules.
7. **Make the best of the situation.** If your nonprofit hasn't recently reviewed the classification of your workers, now is a great time to do it. The rule changes can be an opportunity to begin the good practice of regularly reviewing whether your workers are [employees or independent contractors](#) and whether they are exempt or nonexempt from FLSA.
8. **Panic!** (But only if you are reading this article for the first time after December 1, 2016!)

This Guide is not intended to constitute legal advice. Please consult with a labor and employment attorney for specific questions on how these changes apply to your organization. Nonprofits are also advised to consult the U.S. Department of Labor website at www.dol.gov/whd/overtime/final2016, outside counsel, and/or other appropriate business advisers for more specific guidance.

If you are reading a printed copy of this Guide, the digital copy at www.kynonprofits.org will contain referenced links.

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