



DON'T UNDERESTIMATE OVERTIME CHANGES

A LOOK INTO
OVERTIME UNDER THE FLSA
AND HOW BUSINESSES CAN PREPARE

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Introduction

On Sept. 24, 2019, the U.S. Department of Labor (DOL) released its final rule that boosts the salary threshold at which workers are eligible to receive overtime, making a major change to employee exemption criteria under the Fair Labor Standards Act (FLSA). Effective Jan. 1, 2020, this extends overtime protections to more than 1.3 million currently exempt workers making less than \$684 per week (or \$35,568 per year) and over 100,000 highly compensated employees making less than \$2,066 per week (or \$107,432 per year).¹

This salary-level threshold increase could represent financial and operational challenges for employers, who now must evaluate how their employees are scheduled and paid in order to make the types of workforce decisions that will mitigate their labor costs *and* their exposure under the FLSA.

This in-depth white paper can help employers prepare by providing:

- *an overview of the final rule*
- *potential challenges it could bring*
- *steps to consider in overcoming those challenges and*
- *how technology can help*

Chapter 1

UNDERSTANDING THE FINAL RULE

A BRIEF OVERVIEW OF THE FLSA

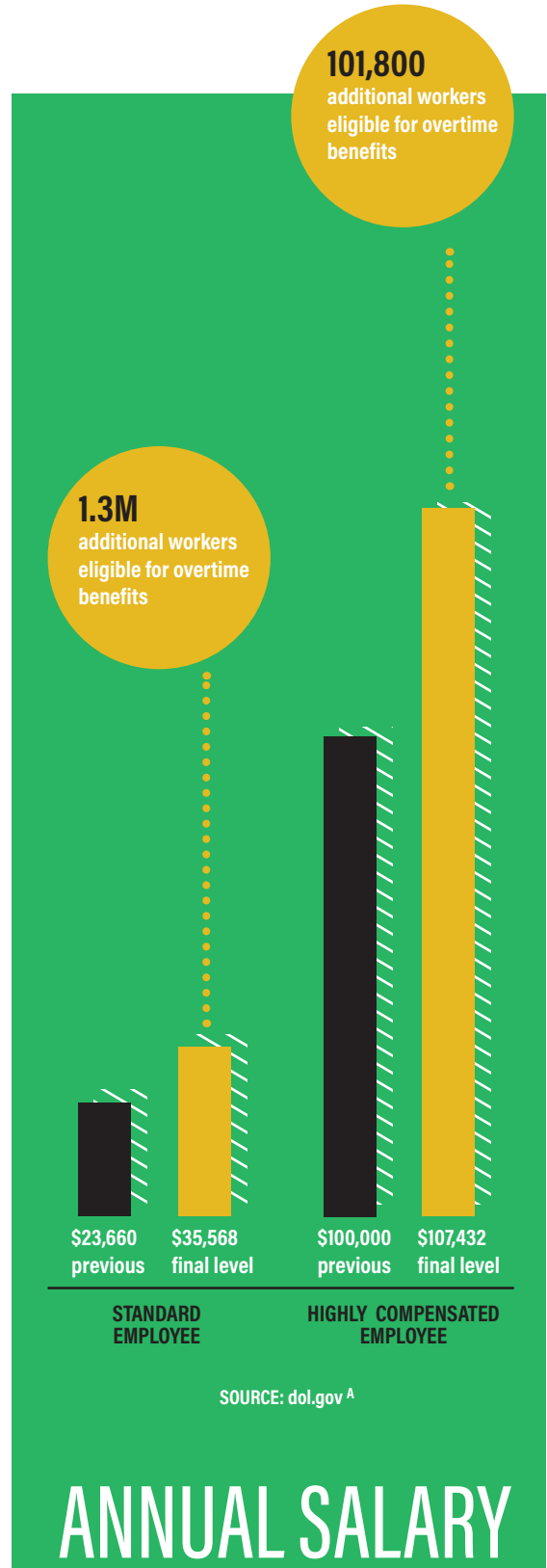
The FLSA regulates child labor, the federal minimum wage and the maximum number of hours an individual can work in a workweek. The law also defines which employees are considered exempt and nonexempt from receiving overtime pay.

According to the FLSA, employers must satisfy three requirements before an employee can be considered exempt, and be excluded from minimum wage, overtime regulations and other rights and protections afforded to nonexempt workers. The first requirement is the “salary-level” test or threshold. To be considered exempt, an employee must be compensated at a rate that meets or exceeds that level.²

A LOOK AT THE FINAL RULE

In March, the DOL issued a notice of proposed rulemaking on overtime regulations which sought to adjust the salary level to account for inflation and put it on par with the 20 percentile of earnings for full-time, salaried workers in the lowest wage census region – currently the South – and/or in the retail sector nationwide.³ This percentile was determined by the DOL, based on data from Current Population Survey earnings data from 2015-2017 and projected to a January 2020 rate.⁴

The final rule increases the salary threshold from \$455 per week (the equivalent of \$23,660 annually) to \$684 per week (the equivalent of \$35,568 annually) for employees in the standard executive, administrative and professional exemptions. The salary threshold for highly compensated employees also increased from \$1,923.08 per week (the equivalent of \$100,000 annually) to \$2,066 per week (\$107,432 annually).⁵



SOURCE: dol.gov^A

ANNUAL SALARY THRESHOLD

REACHING THE STANDARD SALARY THRESHOLD:

BONUSES AND COMMISSIONS COUNT

According to the Department of Labor, under the final rule, employers will be able to use nondiscretionary bonuses, commissions and other incentive payments to satisfy up to 10% of the salary level for employees under the standard exemption. The rule requires such payments are paid on an annual or more frequent basis.

Employers also may be permitted to make a “catch-up” payment within one pay period of the end of a 52-week period to bring an employee’s compensation up to the required level.⁶ Such catch-up payments will count only toward the previous 52-week period’s salary amount and not toward the salary amount in the 52-week period in which it was paid.⁷ This is the *first time* bonuses and commissions will count toward satisfying the salary level for these employees.

The catch-up payment provision does not apply to highly compensated employees. They must receive at least the standard salary level per week on a salary or fee basis. However, employers may use commissions and various forms of nondiscretionary compensation as part of highly compensated employees’ total annual compensation.⁸

Details for Sales

Commissions may be included in satisfying the exemption requirements for those employees who meet the Section 7(i) retail exemption. And as long as workers meet the exemption for being an outside salesperson, those employees would not be subject to salary-level requirements at all.⁹

Avoiding Noncompliance

If you’re planning to implement a pay structure that includes bonuses, commissions or draws — or you already have one — it is especially important to consult with your legal counsel to ensure the structure you have in place complies with the FLSA and to find out how the rule could impact it.



While adjusting the salary level via the rulemaking process will give employers time to comment and adjust for increases, it's important to remember the department's ultimate intention: to continually increase the salary level.

FUTURE INCREASES

In an effort to prevent salary levels from becoming outdated and to reduce the need for sporadic increases over time, the rule also commits to a review and potential increase of the salary level every four years.¹⁰ Unlike the 2016 overtime expansion rule that proposed an automatic increase, the department's new intention is to raise the salary level through the rulemaking process. That process includes a period for public comment and departmental review of those comments to propose a new salary level.¹¹

While adjusting the salary level via the rulemaking process will give employers time to comment and adjust for increases, it's important to remember the department's ultimate intention: to continually increase the salary level. That means plans you create to offset increased labor costs under the final rule must be sustainable. Tools you use to create those plans must be scalable. We'll cover more on this in Chapter Four.

FLSA REQUIREMENTS FOR EXEMPTION

Before exploring the impact the final rule could have on businesses, it's important to cover the other two requirements employers must meet before an employee can be considered exempt from earning overtime pay.

The "salary basis" test is the second requirement. To be considered salaried, an employee:

- » must regularly receive a predetermined amount of compensation each pay period (on a weekly or less frequent basis)
- » cannot experience fluctuations in pay because of variations in the quality or quantity of work he/she performed
- » must be paid the full salary for *any* week in which the employee performs *any* work
- » need *not* be paid for any workweek when *no* work is performed¹²

Instances exist in which an employer can dock a salaried employees' pay without revoking his or her exempt status. Some examples include disciplinary suspension, jury duty and unpaid leave taken in accordance with the Family and Medical Leave Act.¹³

In addition, the salary basis tests do not apply to outside sales employees, doctors, lawyers, teachers and certain computer-related occupations paid at least \$27.63 per hour.¹⁴

DUTIES TESTS

The third requirement an employee must meet before he or she is exempt from receiving overtime involves job duties tests. These tests essentially describe the type of work that exempt employees, in various professional disciplines, can and cannot do. To find out which test is most applicable to an individual, employers should consider the most important tasks the employee performs each day and whether those tasks are performed on a recurrent basis. This will help employers determine the employee's primary duties. The law defines "primary duty" as "the main, major or most important duty the employee performs."¹⁵

- » Generally, exempt employees' primary duties include activity that requires discretion, independent judgment, interpretation, analysis and implementation, all of which is free from immediate and constant direction or supervision.
- » Typically, nonexempt employees' primary duties are marked by using manuals, well-established techniques, procedures and established standards to perform routine work or data-reporting duties.

Once an employee's primary duties are identified, an employer can use that information to determine which exemption best fits. To pass the duties test for a specific exemption, the employee must meet *all* criteria of the test.



Chapter 2

THE REGULATORY LANDSCAPE

The FLSA is extensive and complicated, making it easy for even the most well-intentioned employer to be in violation of the law.

The DOL's Wage and Hour Division (WHD) can choose to conduct an investigation into a company's timekeeping and payroll practices at any time. The agency typically acts in response to employees who claim they were not receiving overtime. However, the WHD also launches investigations independently of an employee complaint. According to its website, "the WHD targets low-wage industries, for example, because of high rates of violations or egregious violations, the employment of vulnerable workers or rapid changes in an industry such as growth or decline."¹⁶ Some of those industries include retail, construction, health care and hospitality.¹⁷

While it's true today's DOL has embraced an agenda of outreach and education instead of aggressive enforcement,¹⁸ the department *is* obligated to administering wage-and-hour law. In 2018, the department recovered a record \$304 million in wages owed to workers; an average of \$835,000 in back wages *per day*.¹⁹

Employers in *any* industry who violate provisions of the FLSA can face penalties with varying levels of severity, based on a variety of factors, including whether the violations were willful or made in good faith. Employers who act in good faith, but fail to follow the law, can still be held responsible for back wages and legal fees.²⁰

Repeat offenders or employers who obviously attempt to circumvent the law can be held liable for back wages, legal fees, liquidated damages and other penalties.²¹

PENALTIES CONTINUE TO INCREASE

In 2016, in an effort to keep pace with inflation, the DOL substantially increased penalties associated with employment laws like wage and hour. On July 1, 2016, the maximum per-violation penalty for repeat or willful minimum wage and overtime violations jumped 72% to \$1,894.²² In 2017, the DOL began making annual adjustments to that amount, and in 2019, published a final rule establishing annual adjustments to keep up with inflation.²³ Under that final rule, the maximum per-violation penalty for repeat of willful minimum wage and overtime violations increased to \$2,014.²⁴ The increased penalty applies to violations occurring after Nov. 2, 2015, that were assessed after Jan. 23, 2019.²⁵

The DOL's interpretation of "repeated" and "willful" is important because it can determine whether employers found to be noncompliant pay the maximum penalty per employee. That interpretation may be broader than you would expect. According to Caroline Brown, attorney with Fisher Phillips, "an employer's transgression can be considered a 'repeated' one for penalty purposes, even if it is not factually or legally the same as an earlier one," and the DOL "might be substituting an even lower standard for 'willfulness' as a practical matter."²⁶

CLASS-ACTION WAGE-AND-HOUR LAWSUITS REMAIN A RISK

Although the overall number of wage-and-hour class-action lawsuits decreased from 2017 to 2018, the plaintiffs' bar became more successful at securing favorable certification rulings, according to the 2019 Seyfarth Shaw Workplace Class Action Litigation report.²⁷ According to Gerald L. Maatman Jr., partner of Seyfarth Shaw, "the plaintiffs' bar was successful in prosecuting class certification motions at the highest rates ever as compared to previous years in the areas of ERISA and wage and hour litigation."²⁸

In addition to increased penalties and investigations by the DOL, the threat of successful class action lawsuits — what Maatman calls a "bet-the-company risk"²⁹ — is just *one* challenge employers could face.

Chapter 3

FIVE CHALLENGES BUSINESSES COULD FACE AS A RESULT OF THE FINAL RULE



WHO WILL BE IMPACTED?

The final rule makes employees whose annual salaries are less than \$684 per week (the equivalent of \$35,568 per year) eligible for overtime pay. On Jan. 1, 2020, the rule becomes law, meaning all employers, regardless of company size or industry, are required to comply. According to the DOL, when the final rule goes into effect, 1.3 million currently exempt employees — and 101,800 highly compensated employees — will become eligible for overtime.²⁹

POTENTIAL CHALLENGES BUSINESSES FACE

On its face, dealing with an increase in the salary level looks like a simple question of time and labor. The solution may seem simple as well: Cut a few hours here or reassign a few duties there to avoid increased labor costs. However, because the salary level increase is a 50% jump from the current level, controlling overtime costs might require many changes to how a substantial percentage of your workforce is paid and scheduled.

Changes of that nature, on such a scale, will have far-reaching operational, administrative and cultural impacts.

That is why it is so important for companies to look closely at their workforce *now* to determine the best plan of action. Ultimately, the challenge will be to figure out how to make the necessary workforce changes within your budget without compromising productivity and morale.

INDUSTRY SPOTLIGHT:

NONPROFIT ORGANIZATIONS

Currently, the provisions of the FLSA cover *some* nonprofit employees, but not others. Employees of nonprofits are covered by the FLSA, and are likely to be affected by the final rule if:

- The organization is considered a “covered enterprise,” meaning it makes an “annual gross volume of sales made or business done of at least \$500,000.” Note that income from contributions and donations, when used to further charitable activities, do not count toward that number.
- The employee is “individually engaged in interstate commerce or the production of goods for interstate commerce,” which include tasks like making/receiving interstate telephone calls, shipping materials to another state and transporting persons or property across state lines.

If your organization is considered a covered enterprise, any employee who engages in “commercial activities for a business purpose” and makes less than \$684 per week (\$35,568 per year), would be eligible to receive overtime under the final rule.^B

It’s important nonprofit organizations follow the lead of for-profit businesses and conduct an analysis *now* of how this increase will affect their organizations. According to the National Council of Nonprofits, nonprofit organizations should conduct their evaluations from a mission-based standpoint, which means “answering questions about how [this] increase in minimum salary levels would affect operations, resources and staffing.”^C





CHALLENGE 1:

Managing Overtime



The challenge central to the issue at hand is tracking and managing overtime. Overtime can be a slippery slope for many employers because of how it typically occurs. Employees call in sick and managers contact other employees to help cover shifts. Managers need to fill these shifts quickly, so they reach out to a small group of employees who are most likely to accept extra hours. After the shifts are covered and payroll is calculated, management sees that several members of this core group of employees have incurred overtime. Unfortunately, there is nothing the employer can do about it; overtime was discovered only after it happened.

Automated scheduling and payroll systems have given companies the tools they need to communicate the opportunity for additional hours to a wider group of hourly employees. Employers also can establish controls within the system that alert them when employees are getting close to earning overtime.

Not only can these tools help companies manage scheduling and reduce overtime, but they also can provide a big-picture view of how much labor it takes — and how much it costs — for the company to achieve certain levels of productivity. However, this big-picture view of overtime only includes hourly employees. What about those salaried employees making less than \$684 per week (\$35,568 per year)? Under the final rule, these employees would be eligible to receive overtime pay. Knowing how much their contribution costs *now* will be crucial to understanding to what degree the final rule potentially could affect a company.

CHALLENGE 2:

Estimating Overtime for Salaried Employees



So what is the productivity price tag for salaried employees? Most employers understandably would be hard-pressed for an answer. Why would any employer spend the time and money to track salaried employees' hours? That would defeat the purpose of the salary exemption.

However, to prepare, employers may want to begin getting an idea of how many overtime hours those salaried employees who earn less than the final salary level work. Even having just a rough estimate will be helpful in determining the most cost-effective workforce changes you could make to manage overtime costs under the final rule.

TRACKING EXEMPT EMPLOYEES' HOURS

Tracking exempt employees' hours will not negate their exempt status.

In the 2004 overtime exemption preamble, the DOL states, "we agree that employers, without affecting their employees' exempt status ... may require exempt employees to record and track hours."^D

However, docking pay from an exempt employee's salary, for reasons outside of specific instances where it has been deemed appropriate by law, could cause the worker to lose his or her exemption.^E

CHALLENGE 3:

Restructuring Your Workforce



Employers have many options when it comes to restructuring their workforce. Here we will examine the potential effects of two:

1. Converting some employees making less than the new threshold from salary to hourly, which would require the tracking of hours worked and overtime paid, according to the FLSA.
2. Raising some employees' annual salaries past the new threshold and preserving their exempt status, because paying time and a half actually would be more expensive in the long run.

Where employers might choose to draw the line in regards to which employees are converted to hourly and which employees' salaries are raised will depend on several factors, including:

- » the number of current salaried employees under the threshold,
- » how much overtime they currently work,
- » employees' prospective time-and-a-half rates and
- » the cost of hiring enough employees to pick up extra work

Regardless of which choices employers make, the effects of these decisions could manifest themselves differently throughout a workforce and organization.

Let's explore a hypothetical scenario in which an employer chooses to use a combination of both methods described to cost-effectively restructure his or her workforce. As a result, there is a group of employees whose annual pay was not raised above the new threshold.

Previously considered salaried employees, they now have been converted to hourly. Now that these employees are eligible to receive overtime, they will have to be diligent about keeping track of their time. The problem is they are not used to doing it. What they *are* used to doing is starting their day without having to clock in. They *are* used to checking their mobile devices at home, responding to emails or completing tasks after hours, without reporting it as hours worked. If these newly nonexempt employees were to perform either of these actions, *they* would be working "off the clock" and the employer could be at risk for a wage-and-hour violation.³¹

Employees whose salary was raised above the new threshold likely would take on exempt duties that previously were performed by newly nonexempt employees. If, for example, you change the pay structure of some employees from salary to hourly, you might consider reassigning exempt duties, if performing some of those duties would cause a newly nonexempt employee to incur overtime.

Job descriptions would need updating and "raised salary" employees might need training to fulfill their expanded roles.



CHALLENGE 4:

Experiencing Increased Costs



The DOL estimates that under the final rule, the average annualized direct employer costs in the first 10 years will be approximately \$173.3 million, including \$543 million in the first year and \$99.1 million in the tenth year.³¹

While it is hard to say exactly how much a specific employer's costs could increase, it is easy to see how they can begin to stack up. Some costs would be apparent and immediate, like those associated with increasing some employees' annual salaries above the new salary level. Additional salary increases may be in order for those employees working at pay grades above those whose annual salaries would get bumped past \$684 per week, or \$35,568 per year.

Other costs subtly will emerge over time, born from the operational implications of making workforce adjustments on such a massive scale. Some of those may include:

- » recruiting and hiring more employees — whether full time, part time or seasonal — to cover the workload left by previously exempt employees who have been converted to hourly, nonexempt status
- » initial overtime costs that result from poor timekeeping practices by newly nonexempt employees unaccustomed to tracking their hours
- » hiring additional human resources staff to track time, process payroll and handle other employment issues for a larger hourly workforce

The cost of lower employee morale also may become a problem. For some workers, being a white-collar, salaried employee represents the achievement of a professional milestone; therefore, they may experience negative feelings if they are converted to an hourly compensation method.

If unaddressed, these feelings can compromise productivity or result in turnover, further adding to costs.



CHALLENGE 5: Encountering Added Risks



Time theft: Any employer who increases the size of the hourly workforce could face a potential increase in time-clock-related time theft. Twenty-one percent of hourly employees admit to stealing company time, through buddy punching (5%), punching in or out earlier or later than scheduled (69%) or failing to clock in and out for lunch breaks (14%).³²

COBRA compliance: The employer in our example chose to reduce some employees' hours in an effort to eliminate overtime costs for newly nonexempt employees. If these workforce adjustments made those employees ineligible for employer-sponsored benefits, those changes would be considered a COBRA-qualifying event. It is crucial that employers keep in mind how workforce changes spurred by overtime expansion could manifest themselves throughout the organization, operationally and culturally.



Chapter 4

PREPARING FOR AN INCREASE IN THE SALARY-LEVEL THRESHOLD

Because the new salary-level increase is expected to impact over a million workers, it's important for companies to look closely at their workforce *now* to determine the best plan of action. Ultimately, the challenge will be to figure out how to make the necessary workforce changes within your budget without compromising productivity and morale.

Four important steps businesses might consider taking to offset potential labor cost increases, implement changes and manage any far-reaching effects are:

STEP 1: AUDIT YOUR WORKFORCE

The first step is to audit your workforce. Start with an assessment of your operational needs from a labor standpoint.

Answer the following five questions to get a big-picture view of where you are currently and what your workforce could look like under the new rule:

1. How many exempt employees do you have making less than \$684 per week (\$35,568 per year)?
2. Do those employees pass the duties test for exempt employees?
3. How much overtime do employees work?
4. How much would that overtime cost you under the new rule?
5. Would those overtime costs be substantial or minimal?

If you have a human capital management technology (HCM) solution, gathering the answers to some of these questions is hopefully easy for you.

If you *do not* have an HCM solution, wage and labor reports represent the first of many instances in which technology can support your HR team in planning for workforce changes. With regulations like this one significantly adding to your administrative burden — now *and* every four years — you may want to start thinking about how the right technology can make compliance easier.

STEP 2: EVALUATE THE DATA TO DETERMINE THE BEST COURSE OF ACTION

Wrapping your head around the five questions above can help you begin to establish a plan that makes the most fiscal sense for your business and helps curb labor costs before they even begin to get away from you.

This plan may include electing to raise salaries, transitioning would-be nonexempt employees to hourly pay or employing a combination of these and other restructuring tactics to limit your liability.

In an article published by the Society for Human Resource Management, Paul DeCamp, an attorney and former administrator of the Wage and Hour Division, recommended employers determine whether to have a zone within which employees close to the new threshold get a bump in their salary to maintain exempt status. Anyone under that zone would need to be reclassified.³³

According to DeCamp, another aspect to consider is which approach you might take in setting nonexempt

pay rates. For example, you may need to decide whether you would simply divide the current weekly salary by 40 or if you would lower the hourly rate to account for potential overtime in an effort to replicate the current pay and hours.³⁴

Ultimately, every company is different and you have to figure out what the path forward is for your business and your people. The sooner you can get a plan of action in place, the easier it will be on your HR team *and* all of your employees.

STEP 3: MAKE ANY NECESSARY CHANGES TO POLICIES, JOB DESCRIPTIONS, PROCEDURES AND TECHNOLOGY

Once you have determined a plan of action, make any necessary operational or administrative changes you can, like updating policies and job descriptions.

If, for example, you change the pay structure of some employees from a salary basis to an hourly basis, you likely will need to reassign some job duties to exempt employees. Job descriptions will need to be revised and employees will need to be trained on any new duties. We will talk more about communicating changes and training employees in the next step.

Because you will potentially be adding to your hourly workforce, managing overtime will be more important than ever. Your overtime rules for performing work “off the clock” like checking email or taking phone calls, should be very clear, as noted in *Allen, et al. v. the City of Chicago*.³⁵

In December 2015, a federal judge ruled on a class-action lawsuit brought against the City of Chicago by police officers who claimed unwritten rules discouraged them from filing for overtime for off-duty work performed on their mobile phones.

While the judge ruled against the plaintiffs — and the Seventh Circuit Court of Appeals upheld his ruling in 2017³⁶ — the judge did assert that the police department could have issued a clearer policy. The *Chicago Tribune* reported that the overtime directives issued by the police department were poorly understood, considered guidelines instead of policy and did little to influence behaviors.³⁷ The city paid nearly half a million dollars in legal fees. A clearly defined policy likely would have prevented the suit.

These are just a few examples of the many changes that could be needed to comply with legislation. Along with updates to policies and job descriptions, you might want to ensure you have the tools you need in place to help implement these changes. HCM solutions with document and task management tools can securely

store important documents and policies. You also can ensure training is available for employees who will be performing new duties.

Your HCM solution also should let you build customizable training programs to facilitate these changes. People who are not used to clocking in and out will have to start, so it is important to have a scalable time and labor system that easily can accommodate hundreds of new hourly employees. Your time and labor system should allow you to run hourly reports on employees who may be approaching overtime, track employees' hours based on the job they are working and help prevent time theft or buddy punching, which could increase with the influx of more hourly workers.

It's also important your HCM solution is easy for your entire workforce to use. Giving employees the ability to complete *all* their HR tasks — like clocking in and out, tracking hours, completing training courses, seeing their schedule and more — with a *single* app goes a long way toward simplifying what could feel like a complicated change.

STEP 4: CREATE A COMMUNICATION STRATEGY

As with any workforce change, honest and clear communication with your employees is imperative to achieve a successful transition. Building a communication strategy can help ensure you communicate everything you need to, *when* you need to.


In this strategy, consider including everything from pay rate changes to job duties adjustments or policy updates. It is especially important to think through any communication or discussions regarding reclassification, and ensure employees have a place where they can easily and confidentially ask questions about any changes. Your HCM technology should make facilitating and documenting these conversations easy through a communication platform in its self-service application.

While the DOL hopes the final rule will help raise employee net pay, some HR experts and employers worry that employees could view a reclassification as a demotion or a loss in status,³⁸ which can lead to negativity and disengagement — two attitudes that quickly can impact your *entire* company. Reclassification also could feel like a loss of flexibility to previously salaried employees, which could be hard to adjust to as well.

It is important to *clearly* outline any changes, reassure employees that they are not being demoted and be ready for any questions or concerns they may have along the way. Equipping your managers to have these conversations the right way, and well before changes occur, should be an important part of your strategy.

CONCLUSION

Employers looking for extremely simple solutions may be hard-pressed to find them. To lessen the impact of an increased salary level now and in the future, they can prepare now by tracking overtime of those employees who make less than \$684 per week (the equivalent of \$35,568 annually) and using that data to formulate workforce-restructuring scenarios that make the most fiscal sense for their business.

 < **\$684 PER WEEK**
(the equivalent of \$35,568 annually)

Even though worker advocates have indicated they intend to legally challenge the new rule,³⁹ preparing now can help ensure that employers can adapt quickly and efficiently to meet the compliance deadline, thereby effectively mitigating risk and controlling labor costs.

Paycom offers HCM technology to help you effectively manage time tracking, scheduling, overtime and more. It also allows employees to complete tasks associated with this change, like clocking in and out, signing personnel action forms, taking training courses and more, all in one app.

Learn more about Paycom's HCM technology at [Paycom.com](https://www.paycom.com) or call 800.580.4505.

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ADDITIONAL SOURCES

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^D Society for Human Resource Management, "Legal and Regulatory: Exempt Timekeeping: May an Employer Require an Exempt Employee to Record Hours and Work a Specified Schedule?" shrm.org, July 2018.

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