Evaluating Cost-Saving Workforce Options in Leaner Times

March 2025

In the face of potential federal budget cuts or a government shutdown, many Community Action Agencies (CAAs) are evaluating cost-saving workforce options—from laying off staff to reducing hours or freezing wages. To help CAAs weather tough financial times and protect themselves against potential employment claims, this article provides an overview of some of the more common approaches a CAA may take to reduce staffing costs, as well as some of the key federal legal issues to consider when weighing these options.

Most cost-saving workforce options implicate the Fair Labor Standards Act (FLSA), the federal law that establishes employment and labor requirements, including minimum wage, overtime pay, and recordkeeping for covered full-time and part-time workers. Employees who qualify for overtime pay under the FLSA are called "non-exempt" and those who fit an exemption in the FLSA are called "exempt" employees. This article addresses how some approaches to cost-saving will impact exempt and non-exempt employees differently. For more information on the FLSA, see CAPLAW's FAQ, *Overview of FLSA Principles.*

Since each CAA's situation is different and state laws vary, it is important to consult with an employment attorney in your state before implementing any of these options.

Hiring and Wage Freezes

One of the least disruptive cost-saving approaches is a hiring freeze. As positions become vacant due to normal attrition, a CAA may consolidate or restructure its operations to spread the work among the remaining employees. It is important to be aware of and acknowledge the extra work placed on the remaining employees and the possible decrease in employee morale as a result. Also, this approach may increase staffing costs for non-exempt employees if the increased workload results in them working additional hours at their overtime pay rate.

Holding employees' wages at their current level is another option. Employers generally have the ability to negotiate and determine pay rates for employees. Employees must still be paid for all hours worked during a wage freeze, including overtime for non-exempt workers. CAAs should check any collective bargaining agreements or employment contracts for terms that prohibit wage freezes. Public CAAs may also be subject to local laws that prevent them from interfering with established pay scales and schedules. Finally, to mitigate the risk of discrimination claims, ensure that the pay rate of employees hired during a wage freeze is consistent with that of existing employees.

Layoffs and Severance

One of the most common responses to an economic downturn or a loss of funding is to lay off (i.e., terminate) employees. Layoffs raise a number of legal and practical issues, such as potential discrimination

and retaliation claims, decisions about whether and how to pay severance, and, in some cases, compliance with layoff notification laws.

Layoffs may prompt affected employees to file discrimination or retaliation claims against their former employer. These claims typically allege that the employee was treated unfavorably by the employer because of their protected class (e.g., age, disability, race, sex) or that the employer terminated them in retaliation for asserting legally protected rights.[1] Proper documentation of the layoff process can help CAAs defend against these types of claims. For example, a CAA should document the economic conditions triggering a layoff (such as cuts to specific grants) and any cost-saving measures implemented prior to the layoff. It is also important to design and document an objective process for selecting which employees will be laid off. CAAs should consider forming a committee comprised of human resources and other key management personnel to design the selection criteria and to evaluate employees using those criteria. Since performance evaluations are often a factor in selecting employees to be laid off, it is important to ensure that they are conducted regularly for all employees and that employees are being evaluated on the basis of objective and uniform criteria.[2] Layoffs must also comply with any collective bargaining agreements or employment contracts with employees.

CAAs laying off significant numbers of employees may be subject to the federal Worker Adjustment and Retraining Notification Act (WARN Act). In general, the WARN Act requires covered employers to provide notice 60 calendar days in advance of covered mass layoffs and site closings. For more information about determining whether the WARN Act applies to your CAA and its potential layoffs, see CAPLAW's article, *On Notice: Understanding Federal WARN Act Compliance.*

In some cases, CAAs may want to provide severance payments to terminated employees.[3] Under the Uniform Guidance, federal grant funds may only be used to pay severance where it is required by: (1) law; (2) an agreement between the employer and the employee; (3) an established policy that constitutes, in effect, an implied agreement on the organization's part; or (4) the circumstances of the particular employment.[4] Nonprofit CAAs must also ensure that severance payments comply with IRS rules that apply to 501(c)(3) tax-exempt organizations. The IRS prohibits "private inurement," which means that transactions between a nonprofit organization and an "insider" of the organization must be reasonable and not disproportionately beneficial to the insider. "Insiders" generally include organization officers, directors, key employees, and other individuals with significant influence over the organization's operations. Unreasonable compensation to an insider can result in significant monetary penalties for the insider and those who approved the compensation, called the "intermediate sanctions." To avoid these penalties, decisions about severance policies generally and payments to the executive director specifically should be made by independent board members, not those who stand to benefit monetarily from the decision, and the payments themselves should be reasonable and comparable to the market. If a CAA wants to provide severance to employees being laid off, it should plan ahead and adopt a policy (or agreements with specific employees) that specifies which employees will receive severance and under what circumstances.[5] It should also budget for severance pay.

Employees receiving severance generally should sign an agreement memorializing that they received it. CAAs should consider making severance payments contingent on the release of legal claims employees may have against the organization. Note that certain laws, such as the federal Age Discrimination in Employment Act, require specific procedures and language in agreements.[6] State laws may include additional requirements regarding severance. It is important to work closely with an attorney in your state to structure severance arrangements and draft severance policies and agreements.

Reductions in Pay

Another cost-saving option for CAAs is to reduce wages across the board. For example, a CAA might cut all employees' pay by 15%, either indefinitely or for a specific period of time. Pay cuts are often a last resort because of their significant negative effect on employee morale. Some states have laws that require employers to give notice before changing an employee's pay. This approach also raises FLSA issues for both exempt and non-exempt employees.

Non-Exempt Employees

An employer must take care to ensure that, after a pay cut, its non-exempt employees are still paid at least minimum wage for all hours worked, plus overtime pay where applicable. In the 30+ states where the minimum wage is higher than the federal floor of $7.25 per hour, the state rate will apply to most employees.[7]

Exempt Employees

Following a pay cut, most exempt employees must still be paid at least the federal salary threshold (currently[8] $684 per week) to maintain their FLSA exemption. Failure to pay at least that amount will cause the employees to lose their exemption and be treated as non-exempt—meaning they would be eligible for overtime pay when they work over 40 hours in a workweek.

Reductions in Hours

Reducing employees' hours and corresponding wages on a continuing basis or converting full-time employees to part-time are less drastic alternatives than layoffs or across-the-board pay cuts. Any conversation from full- to part-time should be officially documented, along with any related reduction in fringe benefits. A CAA's policies or benefit plan documents may require employees to work a certain number of hours per week or year to be eligible for specific benefits, including vacation or paid time off.

Non-Exempt Employees

Under the FLSA, an employer must pay non-exempt employees only for the hours they work.[9] Therefore, an employer may reduce the hours and wages of non-exempt employees on a week-to-week – or even day-to-day – basis, or convert them from full-time to part-time without violating the FLSA. Employers must continue to pay part-time non-exempt employees at least minimum wage for all hours worked and overtime pay when applicable. If the pay of non-exempt employees is not reduced at the same rate as their hours, a CAA should be careful to properly recalculate the employees' regular rates of pay to ensure it complies with FLSA regulations.[10]

Exempt Employees

The FLSA generally prohibits an employer from reducing an exempt employee's pay due to fluctuations in hours worked from week to week.[11] However, an employer is not prohibited from reducing an exempt employee's predetermined salary on a go-forward basis during a business or economic slowdown, provided the change is bona fide and not done to evade the FLSA's requirements. Such a reduction will not result in loss of the exemption as long as it is applied prospectively as the result of actual financial difficulties of the organization, reflects the organization's long-term business needs (i.e., not a short-term, day-to-day, or week-to-week deduction), and does not reduce an employee's pay below the current FLSA salary threshold. For example, under these circumstances an employer may change the schedule of an exempt employee who works 40 hours and makes $1,200 per week to 25 hours per week and reduce the employee's salary to $750 per week. Keep in mind, however, that if the resulting salary falls below the current FLSA salary threshold of $684 per week, the employee's exemption will be lost.

Furloughs

Furloughs—temporary leaves of absence without pay—are another possible cost-saving measure. While furloughs vary in duration, furloughed employees are typically still considered employed and therefore many employer obligations (such as benefits) may continue during unpaid leave. Furloughed employees could be also eligible to receive unemployment benefits, which are solely dictated by state law. The form and length of a furlough may impact this eligibility, so consultation with a state attorney familiar with unemployment benefits is prudent.

As is true for all cost-saving measures, decisions as to which employees to furlough should be based on legitimate business justifications and made in accordance with federal and state antidiscrimination laws, such as Title VII of the Civil Rights Act of 1964, to mitigate the risk of furloughed employees bringing suit against a CAA. In a suit where both federal and state laws apply, generally the law offering greater protection to employees will control.

Employers should develop furlough policies to communicate, among other things, the leave status of furloughed employees, that furloughed employees must not work during the furlough, and when a furloughed employee is eligible to receive benefits. Depending on how a CAA's vacation or paid time off (PTO) policy is set up or what state law requires, reducing employee hours via a furlough could impact their accrual of PTO. A furlough policy should also address the use of accrued PTO during the furlough period, as employees may want to use their time to cover the days, although such a practice would defeat the cost-saving purpose of the furlough. Generally, since employers are not required to offer employees PTO, employers have discretion to dictate employees' use of any PTO provided, unless prohibited by state law. For example, an employer could require exempt employees to use accrued vacation time during a CAA shutdown of less than a workweek without violating the FLSA.[12]

Non-Exempt Employees

Since the FLSA requires employers to pay non-exempt employees only for the hours they work, an employer may furlough non-exempt employees for partial days, full days, or full workweeks and reduce

their pay accordingly without violating the FLSA. If non-exempt employees perform *any* work during the furlough period, however, they must be paid for the hours they work. Therefore, a CAA implementing this alternative should communicate and enforce a strict no-working policy during the furlough period, including prohibiting furloughed employees from checking voicemails or emails. One way to facilitate compliance with no-working policies is to require employees to turn in any employer-provided electronic devices during the furlough period.

Exempt Employees

Under the FLSA, an employer cannot deduct from an exempt employee's salary because of variations in the quantity of work performed.[13] So, if an exempt employee performs any work during a workweek, an employer usually must pay the employee his or her full salary for that workweek. However, an employer may furlough exempt employees by requiring them to take off one or more entire workweeks.[14] The employer may deduct pay for a furlough week from an exempt employee's predetermined salary as long as the employee performs no work during that entire workweek. A CAA's strict no-working policy (described above) should apply to exempt as well as non-exempt employees.

Additionally, because the FLSA permits employers to reduce exempt employees' pay for full-day absences from work for personal reasons other than sickness or disability, a CAA may ask for volunteers to take full days off without pay.[15] If an exempt employee volunteers to take one or more full days off without pay for personal reasons, the employer may take deductions from the employee's salary for those days. However, the choice must be entirely voluntary; the employer must not pressure or coerce exempt employees to take days off. In addition, employees who volunteer to take days off must perform no work on those days.

Public CAAs have somewhat more flexibility in structuring furloughs of exempt employees than do nonprofit CAAs. Under the FLSA, state and local government entities, including public CAAs, may reduce an exempt employee's hours and pay from week to week for budget reasons without destroying the employee's exempt status on a permanent basis. However, during the week(s) in which an exempt employee's hours are reduced, the government employer must treat the employee as non-exempt (i.e., require the employee to record all hours worked, pay the employee at least minimum wage for all hours worked, and pay the required overtime premium if the employee works over 40 hours during the week).[16]

Reductions in Fringe Benefits

Reducing or eliminating certain fringe benefits is another cost-saving alternative. Some examples of this option include: reducing employer contributions to retirement plans; reducing the employer share of health insurance premiums; increasing health insurance co-pays or deductibles; or switching to a health insurance plan with lower premiums. These changes will require working with your CAA's benefit plan providers and may also require consultations with advisors such as your retirement plan auditor or an employee benefits attorney. Board approval of any changes or amendments to benefit plan documents may also be necessary. CAAs may consider eliminating or reducing other types of fringe benefits, such as employer-provided transit passes or technology.

END NOTES

[1] E.g., Age Discrimination in Employment Act, 29 U.S.C. § 621 et seq.; Americans with Disabilities Act, as amended, 42 U.S.C. § 12101 et seq.; Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e et seq.

[2] CSBG Organizational Standard 7.6 requires that nonprofit CAAs have "a policy in place for regular written evaluation of employees by their supervisors" and public CAAs "follow[] local governmental policies for regular written evaluation of employees by their supervisors."

[3] Under the Uniform Guidance and Internal Revenue Code requirements for tax-exempt organizations, compensation (including severance) paid to employees must be reasonable. For nonprofit CAAs, where an employee receives more than $150,000 in compensation (including severance) for the year, information about that employee's compensation, including severance paid, may need to be reported to the IRS on Schedule J of the organization's Form 990. Some states also require nonprofits to report certain severance payments to their state charity regulators.

[4] 2 C.F.R 200.431(i).

[5] Although they pre-date the Uniform Guidance, two U.S Department of Health and Human Services Departmental Appeals Board (DAB) decisions illustrate that failing to have a severance policy or agreement in place is likely to result in severance payments being disallowed: *Alcoholism Center for Women*, DAB No. 222 (1981) and *South Central Florida Health Systems Council*, DAB No. 488 (1983).

[6] 29 C.F.R. 1625.22.

[7] A small number of states have laws that set the minimum wage threshold below $7.25 per hour. In those states, the federal minimum wage applies.

[8] As of February 2025.

[9] 29 U.S.C. § 206; 29 C.F.R. 785.11.

[10] 29 C.F.R. 778.321.

[11] 29 U.S.C. § 213; Department of Labor Fact Sheet #17G: Salary Basis Requirement and the Part 541 Exemptions Under the FLSA.

[12] Department of Labor Opinion Letter FLSA2009-2.

[13] 29 C.F.R. 541.602(a).

[14] Department of Labor Fact Sheet #17G: Salary Basis Requirement and the Part 541 Exemptions Under the FLSA (Question 4).

[15] Department of Labor Fact Sheet #17G: Salary Basis Requirement and the Part 541 Exemptions Under the FLSA (Question 6).

[16] 29 C.F.R. 541.710(b).

This material is supported by Grant Number 90ET0505-02 from the ACF Office of Community Services, Community Services Block Grant within the Administration for Children and Families, a division of the U.S. Department of Health and Human Services. Neither the Administration for Children and Families nor any of its components operate, control, are responsible for, or necessarily endorse this material (including, without limitation, its content and any services or tools provided). The opinions, findings, conclusions, and recommendations expressed are those of the author(s) and do not necessarily reflect the views of the Administration for Children and Families and the ACF Office of Community Services, Community Services Block Grant.