Gallagher

Insurance | Risk Management | Consulting

Employer Considerations When Implementing Counting Hours Rules

For applicable large employers, tracking and understanding each employee's hours of service is required in order to make an informed decision on who should be offered coverage pursuant to the Employer Mandate – "pay or play" decision. In addition, knowing an employee's hours of service will assist employers with their IRS reporting obligations under Sections 6055 and 6056 of the Patient Protection and Affordable Care Act ("PPACA").

While employers must follow specific rules when counting hours of service, they do have some leeway in the application of the rules. As such, to assist employers who are trying to set appropriate parameters for counting hours of service, we have created the following questions to help them through the process of establishing measurement, administrative, and stability periods under the look-back method and facilitating use of the monthly measurement method.

Regulations issued in January 2014, which describe the two methods available for counting hours of service to determine an employee's status as a full-time employee (or non-full-time employee), are complex. If you would like a refresher, consider reviewing our article, *Determining Full-Time Employee Status for Purposes of PPACA*, and/or listening to our webinar *Counting Hours Under the Final Rules*.

Methods Available for Counting Hours of Service

1. Which method should we use to calculate hours of service for purposes of PPACA?

Employers must either use the look-back method or the monthly measurement method when determining the employment status of an employee (either as a full-time or non-full-time employee) for purposes of the Employer Mandate and the IRS reporting requirements. Under the look-back method, an employer may determine the status of an employee as a full-time employee during a future period (referred to as a stability period), based upon the hours of service of the employee in a prior period (referred to as a measurement period). If an employer does not use the look-back measurement method to calculate employees' hours of service, the employer must use the monthly measurement method. Using this method, an applicable large employer will determine each employee's status by counting that employee's hours for each calendar month.

Generally, employers will wish to use the look-back method for hourly employees if the employer has hourly employees whose work schedule is variable, such as, variable hour

employees, part-time employees, and seasonal employees. Employers will generally wish to use the monthly measurement method for full-time salaried employees. However, there will be exceptions to these general rules, and each employer must decide which method best suits its employee workforce and business environment.

If an employer uses the look-back method for any employee within a category of employees, the employer must use the look-back method for all employees within that category. Conversely, if the employer uses the monthly measurement method for any employee within a category, then the employer must use the monthly measurement method for all employees within that category. See Question 2 for a list of the available categories.

2. Which categories of employees can we use when determining which method to use to calculate hours of service?

Employers may only divide employees by the following categories: (1) collectively bargained employees and non-collectively bargained employees, (2) groups of collectively bargained employees covered by separate collective bargaining agreements, (3) salaried employees and hourly employees, and (4) employees whose primary places of employment are in different states. Employers must use the same method for all employees within a category of employees. Thus, an employer may not use the look-back method for hourly cashiers and the measurement method for hourly dishwashers within the same state or covered by the same collective bargaining agreement.

The Look-Back Method

3. If we use the look-back method, how do we determine the optimal length of our measurement periods?

There are two different measurement periods. One measurement period is for newly hired employees, called an initial measurement period, and the other is for ongoing employees, called a standard measurement period. Both can be between three to twelve months in length. Moreover, while the initial and standard measurement periods do not need to be the same length, the initial stability period and the standard stability period must be the same length. As such, when choosing the optimal length of their measurement periods, most employers will likely lean towards using twelve-month measurement periods to better manage the fluctuations in hours of service over time. When making this decision, employers must consider employee turnover rates and the administrative burden involved with different measurement period lengths. For example, if an employer chooses six-month measurement periods for both newly hired employees (initial measurement period) and ongoing employees (standard measurement period), then the employer must use six-month stability periods. This can increase the employer's

administrative burden when compared with using a single twelve-month measurement period because certain employees may be required to add or drop coverage up to two times per year.

4. If we use the look-back method, how do we decide when the initial measurement period begins for a newly hired employee?

Employers may begin an initial measurement period on the employee's start date or any date after that up to and including the first day of the first calendar month following the employee's start date (or, if later, as of the first day of the first payroll period beginning on or after the employee's start date). For administrative ease, employers may wish to start on the first of the month following the date of hire. That permits employers to track employees in batches (e.g., employees starting in January, employees starting in February, etc.) instead of by individual start dates. However, if an employer chooses to start an initial measurement period on the first of the month following the date of hire, the time between the first day of employment and the end of the first month of employment counts toward the limitation on the length of an initial administrative period for that employee.

5. If we use the look-back method, how do we decide when an initial stability period begins?

Employers have a maximum period of time of 90 days between the end of an initial measurement period and the beginning of an initial stability period to use as an initial administrative period. As such, the initial stability period must begin no later than 90 days after the end of an initial measurement period. However, there is a special rule which requires employers to limit the time between the date of hire and the beginning of the initial stability period to thirteen-and-a-fraction months. So, if an employer wishes to have a twelve-month initial stability period, it is limited to an initial administrative period of only a month and a fraction. Moreover, if the employer begins the initial measurement period on the first day of the month following the date of hire, then the time between the date of hire and the end of the first month counts as part of the "month and a fraction" administrative period (i.e., it would be the fraction of the month). This means that an employer using a twelve-month initial measurement period would only have one month after the end of the initial measurement period before the initial stability period must begin.

On the other hand, if the employer uses a shorter initial measurement period, the employer may have a longer gap between the end of the initial measurement period and the beginning of the initial stability period, but no more than 90 days. For example, if an employer uses a six-month initial measurement period and a six-month initial stability period, an employee hired on May 4, could have an initial measurement period that

begins on June 1 and ends on November 30. The employer could then have an initial administrative period from December 1 through January 31 with the six-month initial stability period beginning on February 1.

So, when deciding when an initial stability period must begin, each employer must determine how long its initial measurement period will be and then establish the length of its initial administrative period for a newly hired employee.

6. If we use the look-back method, how do we decide when an initial administrative period begins?

When using the look-back method, any period of time between the date of hire and the beginning of the initial measurement period will count toward the initial administrative period. The administrative period can be no longer than 90 days and must comply with the thirteen-and-a-fraction-of-a-month rule for newly hired individuals. Because of the special thirteen-and-a-fraction-of-a-month rule for newly hired individuals, the actual length of the initial administrative period will vary depending upon the length of the initial measurement period. Only employers using a ten-month or less initial measurement period may use a full 90-day initial administrative period. Thus, employers must first set their initial measurement period length, and then they can determine the length of their initial administrative period.

7. How do we decide how long our administrative period should be?

For both ongoing employees and newly hired employees, the administrative period cannot be longer than 90 days – subject to the special thirteen-and-a-fraction months rule for newly hired employees. Thus, employers must backtrack from the beginning of their stability periods to determine where the 90 days prior date falls.

Employers may choose to have administrative periods that are shorter than 90 days, but should consider the impact of the following: (1) when payroll periods begin and end; (2) time needed to verify hours of service with payroll departments and/or supervisors; (3) length of time needed to make eligibility (or ineligibility) determinations; (4) length of time needed to distribute enrollment materials and other communications to impacted employees; (5) length of time needed for employees to return enrollment materials; (6) impact of multiple locations on distribution of materials (e.g., large multi-state employers may need extra time to provide materials to employees located in states other than the state with the home office); (7) employee turnover rate; and (8) how administrative periods coordinate with enrollment periods (e.g., annual enrollment). Thus, practical issues related to administration should be considered when setting administrative periods, in addition to the regulatory requirements.

8. If we use the look-back method, how do we decide when to begin our standard measurement, administrative, and stability periods?

Because employers will generally wish to coordinate their stability periods with their plan years, employers may wish to "back into" their standard measurement periods. Thus, for example, an employer with a calendar year plan year may wish to use January 1 as the beginning of its standard stability period. The employer would then count backwards to determine how long its standard administrative period will be and then use the day prior to the first day of the standard administrative period as the last day of the standard measurement period. For example, an employer with a calendar year plan year may choose January 1 through December 31 as its standard stability period, October 4 through December 31 of the prior year as its standard administrative period, and thus October 3 of the first year through October 2 of the following year (i.e., the year in which the standard administrative period begins) as its standard measurement period.

When planning, it is important to keep in mind that an administrative period that follows a standard measurement period can be no longer than 90 days. Thus, if an employer wishes to maximize its administrative period, it will end its standard measurement period 90 days prior to the beginning of its stability period. However, in setting the standard measurement period dates, the employer may also wish to consider payroll periods and use the beginning of a payroll period as the start date of the standard measurement period. This may mean that the standard measurement period does not begin and end on the same dates each year. For example, the standard measurement period beginning in 2018 for a plan with a calendar year plan year may begin on October 7, 2016 and end on October 6, 2017, but the standard measurement period beginning in 2019 may begin on October 5, 2017 and end on October 4, 2018.

9. If we use the look-back method, can we use different lengths of time for our standard measurement period and standard stability period?

The standard stability period cannot be shorter than the standard measurement period and must be at least six months in duration. However, if an employer uses a three-month measurement period, then the employer must use a six-month stability period. If an employer uses a twelve-month measurement period, the employer generally must use a twelve-month stability period.

For example, if an employer has a plan year beginning on January 1 and uses a twelve-month stability period, the employer will establish its standard stability period as its plan year (i.e., from January 1 through December 31). If, an employer uses six-month standard measurement periods, the employer may still set its standard stability periods to correspond with its plan year, but must use two standard stability periods per year

(i.e., the first one would be January 1 through June 30, and the second one would be July 1 through December 31).

10. If we use the look-back method, how do we count hours of service?

Employers using the look-back method may either count actual hours of service for hourly employees or use one of three methods to count hours of service for non-hourly employees (e.g., salaried employees, stipend employees, employees paid per visit or per mile). The three methods that can be used for non-hourly employees include: (1) counting actual hours of service; (2) a days-worked equivalency; or (3) a weeks-worked equivalency. (These same methods are also available for employers using the monthly measurement method.)

When counting actual hours, employers will include actual hours worked and hours for which payment is due, even if duties are not performed (i.e., paid time off for vacation, holiday, illness, incapacity (including disability in some cases), layoff, jury duty, military leave, or other leave of absence). See our article, *What Counts as an Hour of Service*, for more information about which hours an employee must be credited for. When using an equivalency method, credit will be given for both days involving an actual hour worked and days for which payment is due, even if duties are not performed.

When using a days-worked equivalency, employees are credited with eight hours of service for any day during which the employee would be due one hour of service for an actual hour worked or for which payment is due (e.g., if the employee worked for one hour on Monday, the employee would be credited with eight hours of service for Monday). When using a weeks-worked equivalency, employees are credited with forty hours of service for each week in which the employee would be due one hour of service for an actual hour worked or for which payment is due (e.g., if the employee worked for one hour on Monday, the employee would be credited with forty hours of service for that week). None of the methods used can credit an employee for fewer hours than actually worked. Thus, for example, if an employee works five ten-hour days in a week, the employer cannot credit that employee with only forty hours of service under the weeks-worked equivalency method because the employee actually worked fifty hours that week.

Monthly Measurement Method

11. If we use the monthly measurement method, how do we count hours of service?

Employers using the monthly measurement method will follow the same rules for counting hours of service as used under the look-back method described in Question 10 above.

12. If we use the monthly measurement method, which method should be used for counting our employees hours of service?

If an employer does not have any variable hour or seasonal employees, that employer will likely wish to use the monthly measurement method to determine employee status. An employer will not likely wish to use the monthly measurement method to determine actual health plan eligibility, but will instead only use this method to determine employee status for purposes of PPACA reporting and the Employer Mandate. If an employer were to use the monthly measurement method for eligibility, that would likely result in employees who are eligible for one month or more, but then losing eligibility for a subsequent month or months and thus adding or dropping coverage multiple times per year. This would create an additional administrative burden for the employer and likely lead to employee confusion.

For hourly employees, the employer will be required to count actual hours of service. This means that the employer must have a system in place to account for both hours worked and hours for which payment is due but no work is performed (e.g., vacation and sick time). For non-hourly employees, the employer may not have a means to track employee actual hours of service and may wish to select a less administratively burdensome method such as the days-worked or weeks-worked equivalency method. Which equivalency method an employer may decide to choose will depend upon the structure of the employer's workforce. For example, if an employer has full-time hourly employees, full-time salaried employees, and a dozen or so part-time hourly employees who work no more than 20 hours per week, then the employer would likely wish to use the actual hours of service method for the hourly employees and the weeks-worked equivalency method for all salaried employees. This would enable the employer to use payroll records for all hourly employees while permitting the employer to use a simplified method for salaried employees.

However, employers should be cautious when deciding which positions will be subject to the days-worked or weeks-worked equivalency method. For example, if an employee works four hours per day and four days per week, using a days-worked equivalency method would result in a determination that the employee is to be created with 32 hours

of service per week and thus treated as a full-time employee for purposes of PPACA. Such an employee could trigger a penalty for the employer if he or she obtains coverage through the Marketplace with premium assistance.

Furthermore, when selecting a tracking method, employers will wish to consider the number of full-time versus part-time employees, the number of hourly versus salaried employees, the means of tracking hours of service for non-hourly employees, the number of hours worked per month by non-hourly employees, and the administrative burden of tracking hours of service for non-hourly employees. This will enable the employer to see how many employees must have their actual hours of service tracked versus the number of employees for whom the employer could simply use an equivalency method.

In addition, in selecting an equivalency method, employers should consider how many days per week a particular category of employee works and whether the employer has control over that employee's schedule. For example, if a home health care worker makes six home visits per week, the employer could use a days-worked equivalency method and require the employee to make those visits on no more than three days per week. That employee would then be credited with eight hours of service for each of the three days worked for a total of twenty-four hours of service for that week. However, if the employer cannot control the employee's schedule, then it would be better to adopt a process to track actual hours worked.

Conclusion

Every applicable large employer must carefully consider the impact of choosing a system to count hours of service. But with careful planning, employers will be well able to correctly administer the new rules related to counting hours of service for purposes of PPACA.

The intent of this analysis is to provide general information regarding the provisions of current federal laws and regulation. It does not necessarily fully address all your organization's specific issues. It should not be construed as, nor is it intended to provide, legal advice. Your organization's general counsel or an attorney who specializes in this practice area should address questions regarding specific issues.