AFFIRMATIVE ACTION UPDATE

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THE END OF THE WORLD AS WE KNOW IT?

OFCCP'S NOTICE OF RESCISSION OF THE 2006 COMPENSATION ANALYSIS STANDARDS

On February 28, 2013, the OFCCP issued two documents which, if you believe the majority of writers and commentators who weighed in on the topics, signaled the end of the world as we know it for employers subject to the jurisdiction of the OFCCP. On that date, the Agency published a notice in the Federal Register stating that it was rescinding the 2006 Standards on how the Agency would address systemic discrimination in compensation. Also published was Directive 307 on "Procedures for Reviewing Contractor Compensation Practices."

According to most pundits from both the legal and affirmative action vendor community, by rescinding the 2006 Standards and publishing Directive 307, the OFCCP is throwing the contractor community a curveball likely to result in substantial additional time and cost for complying with the new Directive.

To which we reply: Sit down, take a deep breath, and relax. The world is not ending.

There is really nothing new in either the notice of rescission or the Directive. Basically, the OFCCP is merely going back to the way it used to look at compensation, prior to the 2006 Standards. The hoopla surrounding the change is largely overblown and more than a little self-serving on the part of the lawyers and vendors. That being said, let's step back and see, "What has actually happened?" "What does this mean for contractors?" and "What steps should contractors be taking going forward?"

WHAT HAS ACTUALLY HAPPENED?

In reality, not much.

The OFCCP has always had the ability and authority to look at compensation. Historically, they simply have chosen not to spend much time doing so.

When a review of compensation did occur, the Agency would generally utilize the established and fairly well understood Equal Pay Act (EPA) analysis which compares the wages of males/females and minorities/non-minorities in equal jobs. The EPA states employers cannot discriminate with regard to wages between employees on the basis of gender where employees are in equal jobs that require equal skill, effort, responsibility and the jobs are performed under similar working conditions.

Under the EPA, pay differences are permitted when due to:

- a seniority system
- a merit system
- a system measuring earnings by quality or quantity of production; or
- any other system not based on gender

While the EPA is specific to differences in wages based on gender, the Agency has followed the same type of analysis when looking at differences in wages based on race/ethnicity.

The Agency operated under this model of compensation analysis until 1997 when Joe DuBray, Regional Director for OFCCP's Region III, published a memorandum titled "Systemic Compensation Analysis: An Investigative Approach." The investigative approach set forth in the memorandum became known as the "DuBray Analysis."

The analysis was based on the following assumption. The Agency would use a contractor's own compensation system and look at salary bands/grades/levels/ranges [hereafter "grade(s)"]. The memo assumed that since contractors group jobs into grades, they concluded that all jobs in the grade are similar from a compensation perspective and can be compared. Then the Agency merely compared the average wages of males/females and minorities/non-minorities in each grade. If there was a difference of more than $1,000 between the average wages, the Agency would assume this is an indicator of discrimination. They would request additional data to explain any disparities indicated. If not satisfied, a Notice of Violations (NOV) asking for corrective action(s) would be issued.

Obviously, this approach was seriously flawed. It assumed that all jobs within a grade were the same for purposes of a compensation analysis. However, a single grade might have engineering, information technology, finance, human resources, and supply chain jobs. These are vastly different jobs with different market values; they are not the same or even close to being equal.

From a compliance standpoint, some contractors were initially browbeaten into large settlements based only on average pay differences between protected/non-protected groups within a grade. However, the OFCCP soon returned to doing what it had always done, focusing on entry-level disparate impact hiring cases. Compensation was simply not a high priority at that time.

In 2004, the Agency began the formal rulemaking process to introduce new standards for analyzing compensation. These standards were finally implemented in 2006. The standards called for the creation of Similarly Situated Employee Groupings (SSEGs) and conducting regression analyses on the groups to determine if differences in wages between males/females and minorities/non-minorities were statistically significant. The Agency also published guidelines that allowed contractors to undertake voluntary self-analysis which the contractor could submit to the OFCCP in the event of an audit. If the contractor discovered issues under their self-analysis, they were expected to remedy the disparities. This included providing up to two years of back pay from the start of the review as well as pay for the time it took to identify and correct any unexplained differentials.

Not surprisingly, the contractor community generally ignored the new standards and voluntary guidelines. Overall, the OFCCP continued to spend little time looking at compensation. The Agency did start to utilize what was known as the "Tipping Point Test" to quickly screen a contractor's compensation data submittal in response to Item #11 in the scheduling letter. This test focused on those areas where there was the greatest likelihood of finding an indicator of discrimination. The Tipping Point Test remained in place until sometime in 2010 when the Agency moved to what became known as the "Double Deuce." Essentially, the Agency would look at the data a contractor submitted in response to Item #11 from the OFCCP scheduling letter and compare the average wages of the groups. If there was a difference equal to or greater than $2,000 or 2%, the Agency would request additional data.

Because of these very low thresholds, the Agency began requesting a 12 to 14 item data report for all employees included in the AAP in almost every compliance review. This request may have included:

- Employee ID
- Gender
- Race
- Time with company/date of hire
- Time in position/date in job
- Age (as a proxy for prior experience)
- Current annual base salary or hourly wage
- Part-time/full-time
- Exempt/non-exempt
- Job title
- Job group
- Grade level/salary band
- Employee location
- Other paid allowances (bonus, commission, overtime, etc.)

It remains unclear what the Agency did with this data, but to the extent that there were follow-up questions, they generally focused on differences in wages between employees in the same ("equal") job titles.

This generally describes how the Agency has operated since 2010. So the question becomes, why has the Agency felt compelled in 2013 to formally rescind the 2006 Standards and issue the new compensation Directive? The Directive and the notice of rescission both state that the Agency's actions are driven by the desire to formally endorse Title VII/EEOC methodologies for looking at compensation and not to be constrained by the 2006 Standards.

Directive 307 actually provides very little concrete guidance or insight on how the OFCCP hopes to accomplish this task, except stating that the Agency won't be constrained by the standards. It will follow Title VII principles in looking at compensation and each review will be case specific. More useful information can be found in the Notice of Rescission. The Notice states that the Agency:

- Will apply Title VII principals to the analysis of compensation
- Will require submittal of Item #11 data by job group or grade
- Will continue to use regression analysis where/when necessary

- Will require the submittal of follow-up data in electronic format
- Will look for "measurable" differences or grouping (without explaining what constitutes "measurable")
- Will group employees for comparison into groups where the jobs are similar. Similar is defined as tasks performed, working conditions, job difficulty, minimum qualifications and other objective factors (EPA-like in nature)

TRYING TO READ BETWEEN THE LINES, WHAT CAN WE TAKE AWAY FROM THE ABOVE? HERE IS OUR VIEW ON THE AGENCY'S ACTIONS:

- The Agency appears to be going back to a DuBray-style approach in the initial data submittal when requiring the Item #11 data by job group or grade.

- Regression analysis is an available tool, depending on the sizes of the groups.

- They still need a way to screen initial data submittals to quickly flag cases where there is a higher likelihood of finding issues. In other words, there has to be a consistently applied measurable difference. The question is what will be used as a threshold?

- The Agency will first take a macro review of the data and will then drill down on a micro level if the macro review raises questions.

- If there are differences on the macro level, they will be requesting more detail (12 to 14 item data report).

At the end of the day, what are contractors left with? They are left with a DuBray data submittal; some type of initial screening tool (Tipping Point Test/Double Deuce); regression analysis as a tool (the 2006 Standards); starting at a macro level and then drilling down to small group/individual level of analysis (EPA style methodology); and a more detailed data request (12 to 14 item data report). Thus, contractors will be looking at an OFCCP methodology that is frankly little different from what they have done before.

In other words, **the more things change, the more they remain the same.**

WHAT DOES THIS MEAN FOR CONTRACTORS?

Does the rescission of the 2006 Standards and the issuance of Directive 307 signal the end of the world as we know it for federal contractors and subcontractors?

The answer is "No."

Well then, what does this mean?

It means that at this point, no one really knows for sure what the Agency is going to do moving forward.

WHAT THE AGENCY MAY LIKELY DO

The Agency states in the Directive that it will do the following:

- Conduct a Preliminary Analysis of Summary Data
- Conduct an Analysis of Individual Employee-Level Data (if necessary or appropriate)
- Determine the Approach from a Range of Investigative and Analytical Tools
- Consider All Employment Practices that May Lead to Compensation Disparities
- Develop Pay Analysis Groups
- Investigate Systemic, Small Group and Individual Discrimination
- Review and Test Factors before Accepting the Factors for Analysis
- Conduct Onsite Investigation, Offsite Analysis, and Refinement of the Model

We do know if the Agency had a master plan for implementing the Directive, there would have been extensive communications to the Compliance Officers (COs) in the field as well as the development and implementation of training programs aimed at educating the COs. However, to our knowledge, up to this point there have been no indications of any effort by the Agency to develop internal protocols or training programs to educate the COs in the field on how to implement Directive 307.

If the Agency isn't training its COs on how to implement the new Directive, what can Contractors expect and what should be done to prepare? It is our belief the Agency is likely to continue to do what it has been doing up to this point in time, which is the following:

1. They will receive the Item #11 data by either AAP job group or salary grade. They will look for a measurable difference. The COs will have to come up with some benchmark to determine when a difference is measurable. In the absence of any specific guidance as to what constitutes a measurable difference, they will probably apply something they already know and are familiar with, either the $2,000 or 2% difference previously in place or they may go back to the old DuBray differential of $1,000. We'll just have to watch what happens in future compliance reviews in order to get a sense as to what is deemed to be a measurable difference.

2. If the number of incumbents in the job group/grade is too small for a measurable analysis, the CO may combine some job groups/grades to get sufficient data points in the sample.

3. If differences exist, they'll request the 12 to 14 item report (depending on the CO and the district office) for individual employee data. We have recently seen the Agency starting to ask for Other Paid Allowances (bonuses, shift differential, commission, overtime, etc.).

4. If there are many measurable differences in the Item #11 data, they will likely forward the individual employee data to a regional statistician for a regression analysis.

5. If the regression analysis (based on the factors the contractor claims explain compensation differences) shows statistically significant differences for the pay analysis groups (job group/grade or other grouping), then the CO will be directed either to gather more data explaining individual cohort (job title) differences or go onsite to investigate further.

6. If there are not many measurable differences in the Item #11 report, the CO may still request the 12 to 14 item report for individual employee data. Once the data is received in electronic format, the CO will likely sort it by job title and look for measurable differences in average wages between males/females and minorities/non-minorities. They may also look for measurable differences in wages between the minority subgroups.

7. For example, if Hispanics are the favored subgroup, they may look for explanations as to why Blacks, Asians, and Caucasians earn less than Hispanics.

WHAT STEPS SHOULD CONTRACTORS BE TAKING GOING FORWARD?

If this is what the agency is likely to do, what should I as a contractor/subcontractor be doing to audit our data? How do I determine what to submit to the OFCCP in the event of an audit?

The question is, "Should I be looking at our data in the same manner the OFCCP will be looking at the data?" The answer is, "Absolutely!" But, you cannot stop there. There are actually three different questions to ask.

1. How should I look at our data to understand what may happen if we have to submit it to the OFCCP?

2. How should I analyze our data to protect the company from claims of unlawful discrimination in compensation?

3. How should I submit our data to the OFCCP in the event of a compliance review?

In response to #1: Look at your data the same way the OFCCP will look at it. Prepare an Item #11 report of your AAP population by both AAP job group and salary grade. This means comparing the average wages of males/females and minorities/non-minorities. Look for a measurable difference ($1,000, $2,000, 2%). Candidly, while comparing wages by grade makes little sense, it makes even less sense to do so by AAP job group which may combine many different types of skill sets (engineers, human resources, information technology, finance) spread across many different grades. Trying to conduct an analysis on this population yields no useful information.

While for years we argued against conducting compensation analysis by grade, in this instance (Directive 307) it makes more sense to do so. If there are measurable differences (even in one occurrence), then be prepared for the OFCCP to make a request for the detailed individual employee data. It is most probable that you will get a 12 to 14 item detailed data request.

In response to #2: Once you know that you are going to get a detailed data request, prepare an Item #11 comparison of average wages between males/females and minorities/non-minorities by job title. Again, look for measurable differences ($1,000, $2,000, 2%). Where there is a measurable difference in wages by job title, ask the question, "Is there a legitimate, non-discriminatory explanation for the difference?" Answering this question is likely going to take some time and effort. However, it is the only way to ensure that in the event the OFCCP gets to the point of doing a cohort analysis, you will know whether there are any potential issues for which the OFCCP would demand a remedy.

If there are measurable differences, what are the legitimate, non-discriminatory reasons that explain why a difference exists? Reasons offered by employers include:

- Length of service
- Time in the job
- Job performance
- Prior and total relevant experience
- Starting pay
- Merit pay
- Promotional increases
- Wage progressions
- Union contracts
- COLA
- Other factors such as market conditions

It is critical to remember that the OFCCP's favorite explanation for differences in compensation is time or seniority. In the OFCCP's compensation paradigm, which is based on federal civil service, time in position and time with the government are the two most important factors that explain what an individual is earning. Individuals who have longer service and more time in the job are going to be earning more money than other individuals who do not have as much service or time in the job. Therefore, time is generally what the OFCCP understands and will be most readily accept.

An explanation that we caution against using, even though it is one most employers in the private sector go to first, is job performance. In over 33 years of handling OFCCP compliance reviews, it is our experience that rarely, if ever, does job performance accurately explain a compensation differential. In addition, using performance ratings potentially opens up a can of worms that most contractors do not want to open. If there is a measurable differential in wages between males/females and the contractor uses performance as the explanation, then they are really saying that the females are poorer performers who get smaller raises and earn less money. The next question asked is, "How is performance measured?" If the contractor says "We measure performance with our performance appraisal system," then the next series of questions are:

1. How was the system developed?
2. How is the system applied?
3. How are the raters trained?
4. If the system results in females being rated as poorer performers than males, does it have a disparate impact?
5. If the system does have a disparate impact, has the performance system been validated pursuant to the Uniform Guidelines on Employee Selection Systems?

As you can see, using job performance ratings as the explanation for compensation differentials quickly becomes very complicated and potentially problematic. For this reason, we strongly recommend that contractors, to the extent possible, steer away from performance as an explanation. If it is the actual explanation with supporting documentation, then by all means use it. But it should almost always be a last choice in terms of explaining a compensation differential.

One factor that frequently explains a compensation differential is prior experience and/or prior salary. Many times there is a large difference in compensation where the most recently hired individual (shortest service/shortest time in the job) is the highest compensated. In this instance, a review of the highest compensated individual's job history may reveal that they had 18 years of prior experience and were already earning "X" number of dollars more than everyone else in the job

before being hired. Finding this data may take some digging as prior experience and salary are not usually found in a contractor's HRIS system. If it has been captured at all, this data is found only by a manual data dive of the employee(s) personnel file(s) to retrieve a copy of the employment application.

Conducting a comprehensive analysis of and preparing an explanation for every measurable compensation differential identified is a daunting task under the best of conditions. Starting to do so only after the Agency has made a demand for data will easily increase the stress level. Conducting this type of analysis on an annual basis, (prior to merit planning or after an AAP is written) as a "best practice" will help identify any disparities and determine remedies, if warranted. It is the only way to ensure that your compensation system is working; that there are explanations for any indicators of discrimination in compensation; and that males/females and minorities/non-minorities are being paid fairly based on legitimate, non-discriminatory factors.

In response to #3: In the event of an OFCCP compliance review, "How should I submit our data to the OFCCP to reduce the likelihood of being called on the carpet and having the Agency second-guess the company's compensation decisions?" The answer to this question is:

> Make it as easy as possible for the Agency to reach the conclusions you want them to reach. This means presenting the Agency with data early in the process that explains any questions that may arise.

Contrary to the advice of many OFCCP "experts" to give the Agency as little information as possible, it is our experience that the more a contractor can do to explain a differential early in the process, the greater likelihood that the contractor's explanation will be treated as an explanation, as opposed to an excuse, if the data is forthcoming only later in the process.

To that end, when it makes sense to do so, utilizing the following process when responding to the Item #11 request for compensation data in the scheduling letter can help the OFCCP to draw the conclusions the contractor wants them to draw as quickly as possible.

PROCESS TO RESPOND

1. Submit the Item #11 data by grade.

2. Since there will be measurable differences, the OFCCP will likely request the individualized data. The Agency has already stated they are going to continue to use regression analysis. So beat them to the punch by conducting and submitting a "mini-regression" by grade. Use wages as the dependent variable and gender/race, time with the organization, and time in the position as the independent variables. Submit the results of the mini-regression along with the Item #11 data. Remember, "time" is most often the OFCCP's compensation paradigm.

3. For those grades where there is a statistically significant differential based on gender/race (greater than -2 Standard Deviations or a confidence level of less than 0.05), the Agency has stated it will run a cohort analysis. Beat them to the punch and conduct the analysis for them. For example, if the results of the mini-regression are significant for gender, look at the job titles in the grades where the statistically significant differential exists. Look at every job title where there is a measurable differential based on gender. Prepare and submit an explanation of the legitimate, non-discriminatory justifications for each differential.

4. At this point, the Agency has the Item #11 data. They have a mini-regression using factors they are comfortable with and understand. They have a cohort analysis explaining the differentials for the job titles in the grades that have been flagged. Understanding with all the data submitted, the Agency may still make the individual data request. But instead of embarking on a fishing expedition of their own, they may merely verify the data that has already been provided. This is a lot easier to do and should help to keep them focused on the areas you want them to focus. In essence, the contractor sets up a roadmap the Agency may be inclined to follow as opposed to going off in unknown directions.

ISSUES WITH THE PROCESS

There are some issues with the above process. First, it is dependent on having good data. Generally, most organizations have fairly accurate wage and date of hire data. However, our experience indicates that date in position/job tends to have a lot of accuracy issues due to the way most HRIS systems work. Under most systems, whenever there is a change in job title, department, supervisor, shift, or a change to the HRIS system itself, the system will reset the date in position to the date of the most recent change. This makes conducting a regression analysis using date in position risky at best and damaging to the contractor at worst. Employers choosing to follow the above process must ensure they are working with accurate date in position data.

Second, using the process depends on good overall outcomes using the mini-regression. This means that there are few instances where the results are statistically significant. Remember, we are trying to direct the OFCCP to draw preliminary conclusions that are favorable to the contractor. Therefore, showing that there are few issues will send a positive message to the OFCCP regarding the effects of the contractors' compensation system. Having few issues also reduces the number of cohort analyses the contractor has to research and explain.

Third, the above process is counter-intuitive in that it has the contractor volunteering to give the OFCCP more information than has been asked for. Some contractors will look at the above and simply not be able to overcome years of training to keep OFCCP data submittals to a minimum. In reality, the above process may not make sense if the results of the mini-regression show many statistically significant differentials and/or the results of the cohort analysis show many measurable differentials by job title that cannot be easily explained for legitimate, non-discriminatory rationales. In this situation, the contactor may be better served to submit the minimal amount of data and see what the Agency does with the initial submittal. The Agency could ask for less information than what the Contractor was going to submit if they went the mini-regression and cohort analysis route.

The contractor is going to have to look at their data and make a decision. If they believe the outcomes are more favorable under the process, they may decide to submit all the data. On the other hand, they may decide the outcomes are less favorable, which would cause them to submit only the data requested and wait to see what the OFCCP does.

In any event where there are many differentials, even if the contractor chooses not to disclose the additional information, they should still look at the cohort analyses by job title. Review the measurable differentials, and determine if there are any that cannot be explained. Consider taking steps to remedy those differentials before the OFCCP demands a remedy.

Lastly, the return to looking at the compensation analysis by grades means the recent practice of broadbanding, grade consolidation, and title consolidation will likely result in more compensation differentials occurring. While understanding the rationale behind broadbands and fewer job titles, it does mean that there are more instances where a differential can be found. Candidly, more grades and more titles mean smaller chances of compensation differentials. Contractors may want to give some thought to reversing the practices in past years of going to fewer grades and job titles. This practice does not work to a contractor's advantage when auditing compensation.

SUMMARY

Does the rescission of the OFCCP 2006 Standards on analyzing compensation and the issuance of Directive 307 regarding the new procedures for reviewing compensation signal the end of the world as we know it? Absolutely not.

In our opinion, very little has changed. The Agency is going back to a DuBray style analysis by salary grade. Where they will set the threshold for determining a measurable difference is currently an open question, but this will become clear at some point in the future. They will apply Title VII principals to analyzing compensation, which has always been the rule. They will start looking at compensation on a macro level (by grade) and will move to a micro level (cohort analysis/job title) as they have done in the past.

Contractors still have to conduct internal audits on compensation using Title VII and the Equal Pay Act (EPA). Regression analyses provide a quick tool to focus on areas that may raise the greatest number of questions. However, regression is data dependent and contractors choosing to use this tool must ensure they have the data required and that it is accurate.

Contractors still have to assess their tolerance for risk in terms of deciding whether they will submit more data than requested. Is there some risk associated with volunteering more data than requested? Perhaps. But doing so allows the contractor to be in the driver's seat when it comes to making the data submittal, as well as directing the Agency to draw the conclusions the contractor wants them to draw.

More than ever, contractors must have accurate employee data in their HRIS system. Starting to gather data not currently captured in most systems that is nonetheless critical to explaining why individuals are paid as they are (date in job, prior experience, salary prior to hire, etc.) is essential.

Overall, there is no great change in what the OFCCP has done. Not everything is clear regarding how the Agency is going to go about looking at compensation, but prior behavior gives contractors some hints as to what the OFCCP may do. There is more work involved if contractors want to look at their compensation systems critically and with an eye towards reducing liability.

At the end of the day, the "new" Directive merely makes it clearer that contractors now need to be examining their compensation systems in the manner they should have been looking at them all along.