

COMMENTARY ON PROPOSALS REGARDING SYSTEMIC COMPENSATION DISCRIMINATION

The commentary below is submitted by William Osterndorf of HR Analytical Services. HR Analytical Services is a Milwaukee, Wisconsin based management consulting firm that specializes in assisting federal contractors and subcontractors who need to prepare affirmative action plans for the federal government. Our clients range in size from 60 employees to more than 12,000 employees. HR Analytical Services has developed thousands of affirmative action plans for companies throughout the nation, and our clients have been through successful affirmative action reviews by the OFCCP on a regular basis.

On November 16, 2004, the Office of Federal Contract Compliance Programs (OFCCP) released two separate documents relating to its obligation to review the compensation practices of federal contractors and subcontractors. One of these documents is entitled in part "Interpreting Nondiscrimination Requirements of Executive Order 11246 with Respect to Systemic Compensation Discrimination," and the other is entitled in part "Guidelines for Self-Evaluation of Compensation Practices for Compliance with Nondiscrimination Requirements of Executive Order 11246 with Respect to System Compensation Discrimination." These documents will be referred to below as "Interpreting" and "Self-Evaluation" respectively.

The OFCCP has solicited comments on both "Interpreting" and "Self-Evaluation." While neither document was proposed as a formal regulation, both documents were proposed as guidelines for performing analyses of compensation practices of federal contractors and subcontractors. These documents are meant to provide guidance both for the OFCCP and for the companies that fall under the federal affirmative action regulations. Our comments below are a response to the OFCCP's proposals.

Before moving on, we must state that OFCCP has done the contractor community a great service by releasing "Interpreting" and "Self-Evaluation." It has been clear from recent reviews involving some of our clients that OFCCP is already using the multiple regression approach discussed in these two documents. It is very helpful for contractors to have both OFCCP's rationale for using this approach and to have a procedure for effectively using multiple regression analyses. Our comments below are intended in part to help OFCCP continue to clarify its role in reviewing compensation practices and to clarify the approach OFCCP expects contractors to take in their self-analyses.

OFCCP's Role: Affirmative Action Agency or Equal Opportunity Investigator

Both "Interpreting" and "Self-Evaluation" are predicated on the idea that the OFCCP's primary role is to act as investigator of systemic discrimination claims. The OFCCP states as much on page 67246 of Volume 29 of the Federal Register:

OFCCP conducts compliance reviews to determine whether covered contractors have been engaging in workplace discrimination prohibited by E.O. 11246. As part of its compliance review process, OFCCP investigates whether contractors' pay practices are discriminatory.

While OFCCP has traditionally been considered an affirmative action agency, there is no mention of affirmative action except in the most cursory manner in "Interpreting" and "Self-Evaluation."

The statement on page 29 FR 67246 appears to accurately reflect the OFCCP's current focus on finding and correcting the discriminatory practices of federal contractors and subcontractors. Examples of this decision to focus on discrimination include:

- The use of the Equal Opportunity Survey, which collects data from federal contractors and subcontractors and which can be used for no other purpose than to discern whether there is possible discrimination in hiring, promotion, retention, and compensation;

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 2

- The OFCCP's procedural changes in initiating compliance reviews, which use an initial sorting approach after the submission of affirmative action plans that allows the agency to give its attention on contractors whose AAPs suggest possible discrimination;
- The use of the new Federal Compliance Selection System, which has as its explicit purpose the ability to help the OFCCP select for review those contractors most likely to have practices or procedures that would lead to discrimination.

It appears that OFCCP intends to be the leader in dealing with systemic discrimination in employment. However, it is not clear that this should be the agency's primary role. Executive Order 11246 and the other laws enforced by the OFCCP are both equal opportunity AND affirmative action laws. The requirements under Executive Order 11246 to create affirmative action plans and to make outreach efforts to find, employ, promote, and retain minorities and females were for many years the primary focus of OFCCP's compliance reviews.

In its recent rush to become an investigatory agency, the OFCCP has in many ways abandoned affirmative action as a guiding principle. This abandonment of affirmative action takes two forms. First, the agency's desire to find systemic discrimination causes it to target larger organizations where there is significant personnel activity. Since a finding of systemic discrimination generally requires a statistically significant showing of adverse impact against members of a protected class, the agency must find numbers that are large enough to demonstrate statistical significance. This works to the great advantage of smaller employers and employers with limited personnel activity, as they are much less likely to be the subject of a full compliance review. However, it may also inadvertently cause smaller employers and employers with limited personnel activity to assume that they are no longer required to operate in accordance with the federal affirmative action regulations. Should they become the subject of a full affirmative action review, these employers are less likely to prepare for such a review. At the same time, employees at these companies who might otherwise benefit from the provisions of the affirmative action regulations are less likely to receive the protections these regulations afford.

Second, the agency's desire to find systemic discrimination causes contractors to spend their time on statistical analyses rather than on the development of outreach programs. The OFCCP is requiring an increasing level of sophistication in analyzing statistics, evidenced in no small part by the two documents it has just released on compensation. Contractors are being required to devote significant resources to developing the tools required to evaluate statistical data and to collecting the data that must become part of these statistical analyses. Since companies are not deploying additional dollars or people into human resources departments, the staff in these departments are required to spend time doing statistical analyses that might otherwise be devoted to finding additional recruitment sources to attract minorities and females or to developing promotion and retention programs that might benefit minorities and females.

If the OFCCP has determined that its primary (and perhaps only) mission is to find systemic discrimination, it should take a number of actions.

- First, the OFCCP should exempt smaller companies from its affirmative action plan and compliance review requirements. The agency may want to change its thresholds for completing affirmative action plans from 50 employees and a \$50,000 contract to something more reasonable like 250 employees and a \$250,000 contract.

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 3

- Second, the OFCCP should provide companies with the tools required to prepare appropriate statistical analyses of personnel activity data. Not all human resources (HR) professionals are familiar with standard deviation tests, and a much smaller number are familiar with Fisher's Exact and other tests of statistical significance now used routinely by the OFCCP. The agency should post formulas and explanations of these tests and point companies to free or inexpensive tools that could be used for these purposes.
- Third, the OFCCP should revise its regulations to explicitly acknowledge the new focus on systemic discrimination. The agency should relieve employers from the burden of putting together extensive affirmative action plans that are used to set placement goals, and instead refocus employers on monitoring personnel activity. The agency should also relieve employers from the burden of making outreach efforts, and instead refocus employers on developing procedures to correct discrimination issues identified by tests of statistical significance.

It seems likely, however, that OFCCP's true desire is to integrate its focus on finding systemic discrimination with its focus on helping companies find, hire, promote, and retain members of protected classes. If this is the case, then OFCCP should determine how it will help employers meet their affirmative action requirements while simultaneously helping employers understand how best to analyze statistics for possible disparities.

Using Multiple Regression Analyses

Both "Interpreting" and "Self-Evaluation" are predicated on the idea that companies can and should be using multiple regression analyses to determine whether there are any problems in their compensation practices. It is clear from recent decisions issued by the Office of Administrative Law Judges and from our recent direct experience during OFCCP reviews that the agency is already using multiple regression analyses in order to evaluate compensation practices.

There can be no question that multiple regression analyses are an effective way to evaluate compensation (and various other activities) when there are a sufficient number of persons and factors to analyze. However, OFCCP makes a basic underlying assumption that is simply not true. OFCCP assumes that most contractors have the capacity to prepare multiple regression analyses on their compensation data. From our experience, this is clearly not the case.

Our experience shows several things. First, it shows that smaller companies do not have the expertise in the human resources staff to conduct sophisticated statistical analyses. While HR professionals are growing more proficient with technology, and HR programs at universities are incorporating more information on using statistics effectively, HR professionals generally do not have extensive training in statistics or statistical analysis. At my company, we frequently deal with companies of 500 or fewer employees, and it has been rare to find an individual in the HR department who is well-versed in statistical analyses. In regards to compensation, many smaller companies have no employee who is solely dedicated to compensation planning. The compensation coordinator is likely to wear other hats and have other responsibilities, and rarely has the training or the time to analyze compensation data in the manner that OFCCP has proposed.

Second, our experience shows that larger companies too are unlikely to have the time and talent to do extensive statistical analyses of compensation. The larger companies we are working with have expressed significant concerns about OFCCP's proposals because of the complexity of the proposal and the lack of resources available to them. With increased global competition, many larger companies have reduced headcount and have forced employees to take on additional responsibilities. This is especially the situation in areas like human resources that are not considered to be part of the profit-making centers of the business.

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 4

Thus, a company that 20 years ago may have had an entire compensation department in its human resources function now may have only one or two people handling compensation issues. Compensation professionals are likely to be loaded down with gathering multiple market surveys and developing innovative programs to hire and retain well-qualified employees. It is rare to find a compensation professional who has the time to do extensive statistical studies on pay practices even when that person has the expertise to do so.

Factors to Assess in Analyzing Compensation

OFCCP's admonition to use multiple regression analyses to analyze compensation are further complicated by the lack of instruction on the persons and factors to include in the regression. OFCCP suggests that companies should group together employees who "are similarly situated, based on similarity in work performed, skills and qualifications involved in the job, and responsibility levels." This definition is nebulous enough to allow for many different interpretations of which employees are to be combined for analysis purposes. OFCCP explicitly states that "[p]reexisting [sic] groups, such as pay grades or AAP job groups, are not controlling." In "Self-Evaluation," OFCCP goes so far as to suggest that even job title is not a controlling factor. Unfortunately, there is no additional information that defines how groups are to be analyzed. While we agree that pay grades and similar structures should not always be controlling, it would be very helpful to know more about the factors that WILL be controlling in defining groups of persons to analyze.

It would also be helpful to have a more complete list of the factors that should be analyzed in the regression. OFCCP states that "legitimate factors may include education, experience, performance, productivity, location, etc." Elsewhere, OFCCP indicates that seniority in the job, experience with previous employers, and time in a particular salary grade may be appropriate factors to consider. It is not clear, however, which if any of these factors should always be part of the regression analysis and how many factors a company should use to analyze its compensation practices.

Developing Pools with a "Significant Number of Employees"

In "Self-Evaluation," OFCCP introduces the idea of "Similarly Situated Employee Groupings" or SSEGs. While not explicitly discussed in "Interpreting," the basic concept of a SSEG is introduced there when the agency talks about groups that have similarity in work performed, skills and qualification required, and responsibility levels. However, "Self-Evaluation" expands on the idea of groups of similar employees by stating that SSEGs must be large enough for a meaningful statistical analysis. The agency states that in general, "SSEGs should contain at least 30 employees overall, and contain five or more incumbents who are members of either of the following pairs: male/female or minority/non-minority."

For many employers, and especially for smaller employers, it will be impossible to develop SSEGs that contain at least 30 employees and contain five or more incumbents from one of the noted pairs. Smaller employers already struggle to develop job groups of 30 or more employees, and it is clear from OFCCP's materials that job groups are an inappropriately large grouping to use for compensation analysis. Even for larger employers, there will be situations where significant portions of the workforce cannot be included in SSEGs because they are not in jobs that have sufficiently similar content to other positions.

"Interpreting" suggests that OFCCP may aggregate certain pools of employees in preparing regression analyses. When these types of "pooled" regression analyses are undertaken, OFCCP indicates that the regression is to include the appropriate "interaction terms." OFCCP suggests that it will use the "Chow test" to determine which interaction terms should be included in each pooled regression analysis.

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 5

It may be that a pooled regression would allow smaller companies to properly undertake regression analyses of compensation practices. However, just the text in "Interpreting" regarding pooled regressions is daunting for most of us. While my company has prepared thousands of statistical analyses, we have no familiarity with the "Chow test," nor can we say that we have any comfort level in using "interaction terms." We are certain that companies we are working with have never used a Chow test, and with perhaps one exception we are certain that these companies have not used interaction terms to develop a viable pooled regression.

Self-Evaluation System

"Self-Evaluation" provides a procedure that contractors can use to conduct a self-evaluation of their compensation practices. For contractors of 250 or more employees, this procedure involves the use of multiple regression analyses on at least 80% of the workforce. Contractors are instructed to create SSEGs of at least 30 people as discussed above, and to take action if their multiple regression analyses show a statistically significant relationship between compensation and the race or sex of employees. OFCCP will accept the results of the contractors' analyses as sufficient to preclude further review if the contractor makes data regarding the analyses available during an OFCCP compliance review. OFCCP will not show deference to contractors who use legal counsel to protect the results of compensation analyses.

In its present form, the procedure outlined in "Self-Evaluation" is unlikely to produce the results that OFCCP seeks. Even the largest employers will find it difficult to create SSEGs that have 30 or more employees with at least five matched pairs and to insure that 80% or more of the workforce is contained in an SSEG. While it may be possible to combine entry-level production and clerical positions into viable SSEGs, it is less likely that employers will be able to create viable SSEGs for non-exempt positions requiring a higher level of skill and experience. It is highly unlikely that professional and managerial positions, with their diversity of skill and experience requirements, will fit neatly into SSEGs. Since a significant number of employees are likely to end up outside of SSEGs, companies are unlikely to reach the 80% threshold for covering persons in the workforce. Finally, for the employers that ARE able to create viable SSEGs, there remains the daunting task of conducting multiple regression analyses on its SSEGs.

The employer that emerges from the process of creating and analyzing SSEGs is left with little reward under the system outlined in "Self-Evaluation." In theory, employers who properly conduct compensation analyses will be found to be in compliance with OFCCP's regulations. However, employers who have conducted these compensation analyses according to the procedure outlined in "Self-Evaluation" may still be required to produce extensive materials supporting their conclusions, and it appears that OFCCP continues to have the right to question the manner in which the contractor conducted its analyses. More importantly, any effort by the contractor to afford their compensation analyses the protection of attorney-client privilege negates the presumption of compliance. This places companies in an untenable position: either they can conduct extensive compensation analyses in the hope that the analyses will turn out well and will be accepted by OFCCP without much additional review of materials by the agency, or otherwise take some other course of action that does not meet the procedure outlined in "Self-Evaluation."

While "Self-Evaluation" suggests that some alternate procedure may be used by employers of less than 250 employees, no procedure is actually presented. Thus, it is unclear what the alternative might be for the smaller employer, and under what circumstances OFCCP might accept analyses by smaller employers. It is also unclear whether the standard of 250 or more employees attaches to individual establishments or to the corporation as a whole. This is important because many large employers have single establishments of less than 250 employees.

Various Types of Compensation Analyses Required by OFCCP

In "Interpreting" and "Self-Evaluation," OFCCP has gone to great length to explain its current thinking about compensation and to outline a process for employers to analyze their own compensation practices. However, OFCCP has two other requirements for compensation analyses that do not accord with "Interpreting" or "Self-Evaluation." The agency's Equal Opportunity Survey (EOS) has a very different mechanism for analyzing compensation. While the compensation analysis in the EOS has been widely disparaged, it remains part of the EOS and thus must be completed by the employers that receive the EOS. The agency's current scheduling letter has yet another mechanism for analyzing compensation. The scheduling letter basically relies on the grade approach that OFCCP now suggests is not a viable basis for proper compensation analyses.¹ However, until the scheduling letter is changed, employers are required to submit information in this manner and the agency (at least in theory) must review this information.

Suggestions Regarding Compensation Inquiries

We have the following suggestions to make in regard to the points raised above. We submit these suggestions in the hope that OFCCP will incorporate some or all of these suggestions in any final document(s) that discuss compensation practices.

1. OFCCP Should Acknowledge That Multiple Regression Analyses are Inappropriate for Smaller Employers

It should be clear from our discussion above that smaller employers generally have neither the number of employees required for multiple regression analyses, nor do they have the internal resources to conduct multiple regression analyses. While there may be isolated situations where a small facility with a sufficiently homogenous workforce and a sufficiently well-seasoned HR Manager could prepare multiple regression analyses, this will certainly not be the norm. Thus, OFCCP should acknowledge that other tools can and should be used by smaller employers so that both OFCCP compliance officers and contractors look for effective tools to use in these circumstances.

2. OFCCP Should Provide a Basis for Analysis When Multiple Regression Analyses are Inappropriate

There are a variety of circumstances where multiple regression analyses may not be the best tool for analyzing compensation practices. This is the situation not only for smaller employers, but for employers that have a highly complex workforce where it would be difficult to develop groupings of sufficient size to be statistically meaningful, as well as for large employers who do not have the resources to effectively prepare multiple regression analyses. OFCCP should clarify what type of compensation analysis is expected in such a circumstance.

¹ Item 11 in the current scheduling letter states that contractors must provide "annualized compensation data...by either salary range, rate, grade, or level..." Most contractors with formal salary and wage grades use these grades as a basis for providing the information requested in item 11.

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 7

Another commentator has suggested that OFCCP use a multi-prong approach in conducting compensation analyses.² This approach would incorporate the following points:

- For smaller employers and other situations where there is no way to build meaningful groups of similarly situated employees, contractors and OFCCP compliance officers should resort to a traditional cohort analysis in which there is a comparison of the compensation of employees in the same job title.
- For situations where groups can be developed but there is no way to develop groups of statistically significant size, contractors and the OFCCP should use company-developed mechanisms such as job title and salary grade to prepare mean and median analyses, realizing that salary grades and job titles may at times incorporate jobs and employees who are not similarly situated.
- For situations where meaningful groups of similarly situated employees can be developed that have a statistically significant size, contractors and the OFCCP should use of multiple regression analyses where other, simpler analyses do not explain disparities in the compensation for minorities and females.

Regardless of the approach ultimately taken by OFCCP, the agency should provide for alternate mechanisms to be used when it is not possible to use multiple regression analyses.

3. OFCCP Should List the Factors that Will Be Considered in Developing Groups of Employees

We entirely agree that any grouping of employees to be analyzed should be similarly situated: that is, they should have similarity in job content, skills and qualifications, and responsibility level. However, we want to encourage OFCCP to further define what will constitute a group of similarly situated employees. The three factors noted by OFCCP are similar to the three factors used to develop appropriate job groups in affirmative action plans, and history shows that there are many ways to interpret the three factors used to develop AAP job groups. We fear that there will be disagreements between contractors and the OFCCP during compliance reviews on the development of similarly situated groups of employees just as there are now disagreements on the contents of AAP job groups.

It would be helpful if OFCCP would discuss the importance of some of the following factors in developing groups of similarly situated employees: job title, grade, physical location, degree of specialization, department or work unit, seniority group, EEO-1 group, and AAP job group. This list is neither comprehensive nor does it necessarily include the most critical factors in developing groupings for compensation analyses. We are simply suggesting that a list of possible factors would be very helpful in determining how to develop groups of similarly situated employees. It would be especially helpful to have a list where certain items were designated as more critical than others.

4. OFCCP Should List the Factors that Will Be Considered as Part of a Regression Analysis

We also believe that OFCCP should provide a list of factors that will be considered as part of a multiple regression analysis. These factors could potentially be considered during any other type of compensation analysis as well. OFCCP has already listed several factors that might be considered: education, experience, performance, productivity, location, seniority in the job, experience with previous employers, and time in a particular salary grade. It would be useful to both OFCCP compliance officers and contractors to know whether this is the exhaustive list or whether there are other factors that may be considered. We understand

² This approach was recently suggested by Thomas Nail of Thomas Houston Associates, Inc. We wish to acknowledge his valuable thoughts on this issue.

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 8

that the factors to consider may depend in significant part on each employer and its particular circumstances. However, any additional guidance from OFCCP on the particular factors to use and their potential importance would be useful to OFCCP compliance officers in determining whether compensation has been analyzed correctly and would be useful to contractors in knowing where to begin their analyses.

5. OFCCP Should Develop a Self-Evaluation Process that May Allow More Employers to Participate

The concept that OFCCP should provide a mechanism for self-evaluation of compensation practices is a good one. There should be a way for employers to make a self-evaluation and for OFCCP to accept the results of this self-evaluation. However, employers are not likely to fully embrace any type of self-evaluation process for compensation practices that does not protect them from liability should a problem be found. If OFCCP wants a system where the results of self-evaluations are routinely provided by contractors, the agency should provide for some mechanism where the results of these reviews retain a measure of protection from self incrimination. The agency would need to issue a formal regulation that would limit the accessibility of any compensation self-evaluations and that would retain the protections afforded by attorney-client privilege.

OFCCP should also provide for a process of self-evaluation that does not necessarily require the use of multiple regression analyses or the development of specialized structures such as SSEGs. OFCCP should give contractors the flexibility to use other methods for compensation analyses that more appropriately fit their individual circumstances. OFCCP's compensation reviews should then focus on the viability of the self-evaluation process rather the actual compensation data itself or the use of specific statistical tests such as multiple regression analyses.

6. OFCCP Should Remove the Compensation Analysis from the Equal Opportunity Survey and Conform Its Scheduling Letter to Current Agency Practices

As noted above, OFCCP has done the contractor community a great service by providing instruction on the proper way to analyze compensation practices. However, the agency's own requirements currently ask for contractors to submit information in a way that does not conform to these practices. It is clear that the compensation data requested in the EOS is not helpful to either contractors or the OFCCP, and we strongly encourage OFCCP to eliminate this portion of the EOS.

We also encourage OFCCP to insure that the request for information made in the agency's scheduling letter conforms to the actual manner in which OFCCP intends to analyze compensation. It appears that the salary grade approach currently found in the scheduling letter is not helpful to OFCCP. If it is OFCCP's intention to ask for compensation data on each individual employee at the start of a review and to evaluate compensation using multiple regression analyses, the scheduling letter should be revised accordingly. While it would create a burden on employers to provide this data, at least contractors would know what to expect. If instead OFCCP intends to reserve the right to ask for compensation data on specific individuals, jobs, or other groupings, item 11 should be removed from the scheduling letter. OFCCP compliance officers could then ask for compensation data at a later point in the compliance review process.

Commentary on Proposals Regarding Systemic Compensation Discrimination
Prepared by HR Analytical Services
November 30, 2004
Page 9

Summary

The comments in this submission are meant to help OFCCP clarify its position on compensation analyses (and potentially to help OFCCP clarify its overall mission). We welcome OFCCP's effort to educate contractors on the agency's priorities and procedures, and we encourage OFCCP to continue to provide additional information to contractors. Our hope is that the comments above and the suggestions made will help OFCCP further refine its thinking on this important matter and provide a basis for additional interaction with contractors.

Sincerely,

William A. Osterndorf, President
HR Analytical Services