1. **SUBJECT:** Analysis of Contractor Compensation Practices During a Compliance Evaluation

2. **PURPOSE:** To outline standard procedures for reviewing contractor compensation practices during a compliance evaluation and emphasize OFCCP’s priority of eliminating pay discrimination through enforcement by OFCCP and compliance by contractors through proactive self-auditing.


5. **BACKGROUND:** Beginning in 2006, OFCCP relied on two guidance documents to establish analytic procedures to be followed generally by OFCCP when evaluating systemic compensation violations of Executive Order 11246 (the Compensation Standards), and to establish certain compliance procedures (the Voluntary Guidelines). The Compensation Standards and Voluntary Guidelines were rescinded in February 2013 and replaced with DIR 2013-03, Procedures for Reviewing Contractor Compensation Systems and Practices (commonly referred to as Directive 307).

OFCCP enforces the nondiscrimination provisions of Executive Order 11246, including the ban on compensation discrimination, following Title VII, under which courts consistently hold that there is no single way to prove discrimination. DIR 2013-03 was issued, in combination with other OFCCP guidance and training, to provide clarity to contractors and improve equal employment protection for workers.

Upon further review of Directive 307, and because OFCCP now receives individual-level compensation data as part of the scheduling letter submission, OFCCP has decided to update the guidance set out in Directive 307. OFCCP is concerned that contractors lack the clear guidance Directive 307 intended to give. OFCCP believes that fulsome guidance will further support contractors’ ability to conduct meaningful self-audits so that they can proactively identify and address issues with their compensation practices.
Pay discrimination by federal contractors is unlawful, and its elimination is a key enforcement priority for the agency. OFCCP, however, can only audit a small proportion of all contractor establishments per year. Therefore, facilitating proactive compliance is an important component in achieving this objective. This new directive will support the agency’s efforts to eliminate pay discrimination through both enforcement and compliance.

Therefore, OFCCP is rescinding DIR 2013-03, and issuing DIR 2018-05 to: (1) further clarify and provide additional transparency to contractors about OFCCP’s approach to conducting compensation evaluations; (2) support compliance and compensation self-analyses by contractors under applicable law, and OFCCP regulations and practices; and (3) generally improve compensation analysis consistency and efficiency during compliance evaluations. DIR 2018-05, as detailed in the attachment, is more transparent about the agency’s practices and approaches to determining similarly-situated employees, creating pay analysis groups, conducting statistical analysis and modeling, and other analytical matters relevant to conducting sound, compensation compliance evaluations and contractors’ self-audits. Ultimately, OFCCP believes that this new directive will provide clear guidance to contractors, which will result in more effective self-auditing, and benefit American workers by facilitating the elimination of pay discrimination.

6. ROLES AND RESPONSIBILITIES:

Regional and Field Managers: It is the responsibility of regional and district directors to ensure that regional and field staff conduct compensation analyses and evaluations consistent with the procedures stated in this directive.

Regional and Field Staff: It is the responsibility of compliance officers and other employees responsible for conducting or assisting with compliance evaluations to conduct compliance evaluations involving compensation as required by the procedures set forth in this directive.

National Office: It is the responsibility of OFCCP’s national office staff responsible for analyzing contractor compensation information to act in accordance with the procedures stated in this directive.

7. PROCEDURES:

Attached.
8. **CONFIDENTIALITY OF INFORMATION:**

The Freedom of Information Act (FOIA), 5 U.S.C. § 552, applies to all information/data submitted pursuant to this Directive. Upon receipt of a FOIA request, OFCCP evaluates all information submitted by contractors pursuant to the public inspection and disclosure provisions of FOIA and the Department of Labor's implementing regulations at 29 CFR Part 70. OFCCP requires that a contractor affected by a FOIA disclosure request be notified in writing and no decision to disclose information is made until the contractor has an opportunity to submit objections, if any, to the release of the information. Moreover, OFCCP does not release data obtained during the course of a compliance evaluation until the investigation, and all subsequent proceedings, if any, are complete.

At 41 CFR § 60-1.20(f), the regulation provides in part that if the contractor is concerned with the confidentiality of information such as lists of employee names, reasons for termination, or pay data, then alphabetic or numeric coding or the use of an index of pay and pay ranges, consistent with the ranges assigned to each job group, are acceptable for purposes of the compliance evaluation. Regardless, the contractor must provide full access to all relevant data pursuant to 41 C.F.R. § 60-1.20(a)(1) and § 60-1.43.

9. **INTERPRETATION:**

This Directive does not create new legal rights or requirements or change current legal rights or requirements for contractors. Executive Order 11246, as amended, Section 503 of the Rehabilitation Act of 1973, as amended, the Vietnam Era Veterans' Readjustment Assistance Act of 1974, as amended, OFCCP's regulations at 41 CFR Chapter 60, and applicable case law are the official sources for contractors' compliance responsibilities. Nothing in this Directive is intended to change otherwise applicable laws, regulations or other guidance or to restrict or limit OFCCP's ability to perform compliance reviews, request data, or pursue enforcement of any issue within its jurisdiction. This Directive is not intended to have any effect on pending litigation, nor would this Directive have altered the agency's basis for litigating any pending cases. The intent of this Directive is to provide greater clarity regarding the compliance review process, which will allow contractors to perform self-audits and come into full compliance in advance of a compliance review or enforcement matter.

10. **EFFECTIVE:**

The procedures established in this Directive apply to all OFCCP reviews scheduled on or after August 24, 2018, and they apply to open reviews to the extent they do not conflict with OFCCP guidance or procedures existing prior to the effective date.

Craig E. Leen  
Acting Director  
Office of Federal Contract Compliance Programs
ATTACHMENT

Program Priorities

Federal contractors are legally prohibited from engaging in pay discrimination. Enforcement of this prohibition is a key OFCCP priority. OFCCP aligns its compensation compliance evaluation procedures with principles under Title VII of the Civil Rights Act of 1964 (Title VII), as amended by the 1991 Civil Rights Act. Title VII allows for discrimination claims under two different theories: disparate treatment and disparate impact. A disparate treatment claim can be based on an individual allegation of intentional compensation discrimination or a pattern or practice allegation of intentional compensation discrimination at the group level. At this group level, statistical results can create an inference of unlawful intent.  

A disparate impact claim involves an allegation that a facially neutral policy or practice unintentionally results in group-level compensation disparities.

OFCCP focuses on identifying and resolving compensation disparities through its compliance evaluations where there is evidence that the disparities were the result of systemic discrimination, whether pattern or practice discrimination, disparate impact discrimination, or both. This is consistent with OFCCP's strategic focus on high-impact systemic cases as articulated in DOL's 2018-2022 Strategic Plan.

Where OFCCP believes there are indicators of systemic discrimination in compensation, it will seek to fully understand the contractor's compensation system, policies and practices through interviews with the contractor's subject matter experts and employees and a holistic review of the contractor's EEO and diversity and inclusion policies. Additionally, where OFCCP believes there are indicators of disparate impact in compensation, it will work collaboratively with the contractor to understand any defense that a policy or practice that caused the disparate impact is job-related and consistent with business necessity, and will fully consider supporting evidence the contractor provides.

OFCCP considers a variety of employment practices that can lead to compensation disparities among similarly-situated employees, including inter alia:

- Monetary compensation in the form of salary or pay rates, bonuses, commissions, pay additions, or other forms of incentive pay;

- Training or advancement opportunities; and

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4. This Guidance does not impose additional conciliation burdens on OFCCP beyond those in the regulations at 41 C.F.R. § 60-1.20(b).
• Assignment outcomes such as placement into particular jobs or differential access to earnings opportunities such as assignment to preferred contracts or territories.  

*Use of Statistical and Other Evidence*

OFCCP uses statistics to evaluate contractor pay practices under Executive Order 11246, and this approach is appropriate and consistent with Title VII principles. The U.S. Supreme Court has upheld the use of statistical analyses to constitute *prima facie* proof of a pattern or practice of discrimination. OFCCP performs statistical analyses during its compliance evaluations and also seeks a variety of other types of non-statistical evidence. This includes anecdotal evidence drawn from the review of documents and interviews with managers and workers.  

In determining which cases to pursue, OFCCP will be less likely to pursue a matter where the statistical data are not corroborated by non-statistical evidence of discrimination unless the statistical evidence is exceptionally strong. Nonetheless, there may be factors, applicable in a particular case, which explain why OFCCP was unable to uncover anecdotal evidence during its investigation despite the strength of the statistical evidence of systemic compensation discrimination.  

*Data Request and Review Procedures*  

When OFCCP schedules a contractor for a compliance evaluation, OFCCP uses its OMB-approved Scheduling Letter to request the contractor’s Affirmative Action Program (AAP) and support data. Upon receipt of a contractor’s Affirmative Action Program and support data, the compliance officer or other responsible staff member will initiate a desk audit. The first step in the desk audit is to review the AAP and data to confirm that it satisfies the requirements of the Itemized Listing in the Scheduling Letter.  

To minimize duplication of work, the compliance officer must not begin the desk audit analysis of the contractor’s compensation data until the submission is complete and acceptable. Guidance on reviewing employee-level compensation data for missing,
incomplete or unacceptable data is in Chapter 1 of the FCCM. If the compliance officer, or other responsible OFCCP staff member, determines that the submission does not satisfy the requirements of the Itemized Listing data request, the compliance officer must contact the contractor to discuss the discrepancies. Moreover, the compliance officer or other responsible person must send a written request to the contractor seeking production of the compensation data as described in the Itemized Listing within seven (7) business days of receipt of the letter. Data the contractor maintains in electronic format must be submitted in a complete, readable and useable electronic format upon request. Failure to provide complete and acceptable compensation data may result in the issuance of a Show Cause Notice.

Similarly-Situated Analysis Groupings

OFCCP defines similarly-situated employees as those who would be expected to be paid the same based on: (a) job similarity (e.g., tasks performed, skills required, effort, responsibility, working conditions and complexity); and (b) other objective factors such as minimum qualifications or certifications.  

OFCCP achieves comparisons of similarly-situated employees in its analysis by:

(1) developing pay analysis groupings (PAGs) of comparable employees; and then

(2) statistically controlling for further structural differences among members of the PAG (e.g., division, business unit, product line, location) and individual employee characteristics related to the contractor’s pay determinations (e.g., company tenure, prior experience, education, grade level). This approach helps OFCCP balance its objective of reviewing contractor compensation practices for potential broad systemic disparities while keeping truly dissimilar jobs with entirely separate pay models separate.

OFCCP’s objective is to use PAGs that mirror a contractor’s compensation system. If a contractor provides its compensation hierarchy and job structure in the submission to the Itemized Listing, OFCCP will attempt to design its analysis based on that structure. Nevertheless, this assumes that the structure provided is reasonable, that OFCCP can verify the structure as reflected in the contractor compensation policies, if necessary, and that the analytical groupings are of sufficient size to conduct a meaningful systemic statistical analysis.  

Information about the contractor’s compensation hierarchy and job structure provides the distinct pay systems, functions, and workforce organization necessary for OFCCP to develop meaningful PAGs and to statistically control for pay-related structural differences within PAGs. For example, an IT contractor may base its job structure on job

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11 In determining reasonableness, OFCCP may review whether employees within each job group are under a similar compensation system and have a similar job function.
12 There is no bright-line rule, and professionals may disagree, about what constitutes sufficient size for a meaningful systemic statistical analysis of an employer’s compensation system. In its preliminary analysis, OFCCP generally seeks to evaluate groups containing employees under a similar pay system performing broadly similar job functions, regardless of group size.
family or job function, and OFCCP may further control for the next level of functional hierarchy. A manufacturing contractor may use AAP job group as its foundational groupings, and OFCCP may further control for lead or technical specialization.

In the absence of information about a contractor’s compensation system, OFCCP will conduct its preliminary desk audit analysis using either EEO-1 or AAP job groups, provided they are reasonable, meet the requirements of 41 C.F.R. § 60-2.12, and are of a sufficient size to conduct a meaningful systemic statistical analysis. OFCCP will control further for sub-job groupings, functions, units, or titles, as appropriate. During the preliminary analysis, OFCCP will also control for tenure, full-time status as well as other factors, as appropriate.

If the desk audit results warrant further review of a contractor’s compensation practices, OFCCP will seek additional information to understand the contractor’s compensation system, elements that drive compensation decisions, and job structure. Based on these facts, OFCCP may broaden or narrow its preliminary PAGs and subsequent data requests to conform its analysis most closely to the contractor’s compensation system and practices, where appropriate.

**Statistical Methodology and Modeling**

Generally, OFCCP will apply the following principles to its statistical analysis of contractor compensation data in the desk audit and subsequent analysis during the compliance evaluation:

- Use multiple linear regression analysis to evaluate information during or subsequent to the desk audit to minimize false positive and false negative results;
- Separately analyze base pay and total compensation, and, if necessary, components of compensation (e.g., bonus, commission, overtime, shift differentials);
- Transform salary to the log of salary in the regression model to account for potentially different pay distributions within PAGs; and
- Analyze statistical outliers for indicators of potentially inappropriate pay analysis groupings.

**Control Variables**

- Evaluate the effect of sex or race in separate regression models; but OFCCP may explore the interaction of sex and race in subsequent models, as necessary;

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13 See FCCM, Chapter 1 for review of EEO-1 and AAP Job Group acceptability.
14 See FCCM, Chapter 1 for OFCCP Desk Audit procedures.
• Include sex in the model as a dichotomous (0-1) variable using males as the reference category;

• Control for race/ethnicity by creating a series of component dichotomous (0-1) variables for each race/ethnicity category using the category with more than five (5) employees and the highest average pay in each PAG as the reference category;

• Control for components of employee tenure separately (i.e., time in the current job, other time in the company) to minimize multicollinearity;

• Not automatically include squared tenure terms in the desk audit; but include them in subsequent analyses, if appropriate;

• Control for education categories, if provided, by creating a series of component dichotomous (0-1) variables minus a reference category; this may include combining education categories, as appropriate, to capture meaningful pay differentials;

• May use age as a proxy for prior experience in the desk audit only, if provided, but seek to obtain actual prior experience in subsequent analyses;

• Control for job level or grade, if provided, by creating a series of component dichotomous (0-1) variables minus a reference category; this may include combining job level or grade categories, as appropriate, to capture meaningful pay differentials;

• Evaluate market salary surveys, if provided, on a case-by-case basis depending on whether or not job and pay differential between employees are already sufficiently accounted for in the analysis;

• Control for performance ratings or rankings, where feasible, by creating a series of component dichotomous (0-1) variables minus a reference category; this may include combining performance categories, as appropriate, to capture meaningful pay differentials; and

• Test all variables for neutrality, and omit any variables that it determines from its evaluation are tainted by discrimination.

Findings, Transparency and Conciliation

To facilitate transparency, consistency and resolution of discrimination findings through conciliation, OFCCP will implement the following three practices:

(1) At the conclusion of the desk audit, OFCCP will notify the contractor in writing of the general nature of any preliminary compensation disparities that warrant further information requests or onsite review. For example,
Compensation policies and practices with respect to women in production, sales, and management.

OFCCP does not consider the outcome of a desk audit to be a final indicator of discrimination. A desk audit is a screening procedure. Identification of preliminary indicators does not limit the scope of OFCCP’s authority to confirm compliance with other requirements or investigate other potential violations that it discovers during the course of the compliance review.

(2) OFCCP will attach to any Pre-Determination Notice (PDN) for preliminary discrimination findings (see Directive 2018-01) the individual-level data necessary for the contractor to replicate the PAGs and regression results. The attachment will be in electronic format, such as MS Excel. The PDN provides the contractor a formal opportunity to offer a non-discriminatory explanation for OFCCP’s preliminary findings prior to a finding of a violation. The PDN and the response will be reviewed by the national office. OFCCP will also attach the individual-level data necessary for the contractor to replicate the PAGs and regression results in any subsequent Notice of Violation for discrimination findings if different from the PDN.

(3) To facilitate resolution through conciliation, OFCCP will include representatives from OFCCP’s Branch of Expert Services (professional labor economists or statisticians) in the conciliation process, as necessary, to clarify OFCCP variable coding, statistical methods and findings, or answer appropriate questions about the process and assumptions used in calculating back pay.

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15 Because a compliance evaluation also includes the investigation of other types of possible discrimination (e.g., hiring, termination, promotion) any findings of compensation discrimination are addressed along with other findings.