



United States Government Accountability Office
Washington, DC 20548

June 3, 2005

The Honorable George Miller
Ranking Minority Member
Committee on Education and the Workforce
House of Representatives

Subject: *Fair Labor Standards Act: Labor Made Key Decisions in Studies of Updated Overtime Rule and Contractor Provided Support*

Dear Mr. Miller:

In 2004, the Department of Labor (Labor) updated the rule that determines who is entitled to overtime pay of “time and a half” when they work more than 40 hours a week. As part of the rule-making process, Labor was required to estimate the impact of the updated overtime rule and publish the results in the *Federal Register*. Labor contracted with the CONSAD Research Corporation (CONSAD) to assist the agency in studying the impact of both the proposed and final overtime rule.

Because of your interest in these studies and how they were conducted, we agreed to identify: (1) CONSAD’s contractual responsibilities in assisting Labor with estimating the impact of the updated overtime rule on workers and (2) CONSAD’s actions in carrying out these contractual responsibilities. To determine CONSAD’s responsibilities, we obtained and analyzed two contracts between Labor and CONSAD. The first contract covered CONSAD’s responsibilities related to Labor’s impact study for the proposed overtime rule, while the second contract covered CONSAD’s responsibilities related to Labor’s impact study for the final overtime rule. To determine CONSAD’s actions in carrying out these responsibilities, we reviewed CONSAD’s reports as well as the impact studies for the proposed and final rule that Labor published in the *Federal Register*. In addition, we interviewed officials from Labor and CONSAD. While this review describes the creation of the impact studies, it does not assess the soundness of the studies. We conducted our work from August 2004 to April 2005 in accordance with generally accepted government auditing standards.

Results in Brief

The contracts required CONSAD to provide technical and analytic support to assist Labor in estimating the impact of the updated overtime rule. For

the proposed rule, the contract tasked CONSAD with writing reports on the costs and benefits of the rule as well as the impact of the rule on businesses and state and local governments. Although the contract did not specifically require CONSAD to estimate the impact of the proposed rule on workers, it did provide for CONSAD's assistance in performing other analyses. In keeping with this provision, Labor asked CONSAD to estimate the number of workers who could gain or lose overtime pay as a result of the proposed rule. After CONSAD completed its work on the proposed rule, Labor and CONSAD set up a second contract to have CONSAD assist with the study of the final overtime rule. The contract language covering CONSAD's work on the final rule specifically required CONSAD to estimate the impact of the updated rule on workers. CONSAD was required to provide information on affected workers, including their ages, educational backgrounds, and occupations. For both contracts, Labor was responsible for overseeing CONSAD's work and had the authority to select the direction and scope of CONSAD's analyses.

Consistent with the contracts, CONSAD provided Labor with technical and analytic support, and Labor made all of the key decisions in estimating the impact of the updated overtime rule. CONSAD conducted literature searches, proposed certain research methods, analyzed data, and wrote summary reports. Labor, in turn, selected the research methodologies, picked the data sources, and provided the legal and policy interpretations used in the studies. Labor officials wrote the impact studies published in the *Federal Register*. For the CONSAD reports and the impact studies in the *Federal Register*, Labor noted it was responsible for creating the numbers that estimated the impact of the updated overtime rule on workers.

In commenting on the draft of this report, Labor noted that it concurred with our findings. Labor also provided technical comments that we incorporated where appropriate.

Background

The Fair Labor Standards Act (FLSA) limits the normal work week to 40 hours, requiring most employers to pay hourly overtime wages to employees who work longer than 40 hours. However, employees working in a "bona fide executive, administrative, or professional capacity" are

exempted from the wage and hour standards and need not be paid overtime pay for a work week longer than 40 hours.¹

Under the FLSA, Labor is responsible for setting the criteria for these exemptions, and historically it has formulated specific tests based on the accumulated experience of employers, employees, and its own field staff. In 2003, Labor proposed changes to the overtime rule, partly in response to a GAO report recommending that Labor modernize the rule, which had not been substantially changed in almost 50 years.²

Labor's proposed rule changed the tests used to determine whether employers must pay overtime. For example, under the overtime rule in effect in 2003, workers who earned up to \$155 a week were guaranteed overtime pay (time and a half of their regular rate) for the hours worked beyond a 40-hour work week. Workers who earned more than this amount were subject to various tests, called duties tests, to determine whether their duties exempted them from the overtime pay requirement.³ Under the proposed rule, overtime eligibility for most workers earning up to \$425 a week would be guaranteed. In addition, the proposed rule changed the tests used to determine whether the duties of higher income workers qualified them to be considered executive, administrative, or professional employees and therefore not entitled to overtime pay.

Labor was required to publish its proposed changes to the overtime rule and its estimate of the impact of the proposed changes. Several different statutes and executive orders require executive agencies to prepare impact studies when publishing significant rules.⁴ Accordingly, Labor published both the proposed rule and the related impact study in the

¹Fair Labor Standards Act, section 13(a)(1).

²GAO, *Fair Labor Standards Act: White-Collar Exemptions in the Modern Work Place*, GAO/HEHS-99-164 (Washington, D.C.: Sept. 30, 1999).

³The base salary level test for executive and administrative employees was \$155 per week, and for professional employees it was \$170 per week.

⁴The primary ones include Executive Order 12866, which requires agencies to conduct a cost-benefit assessment of "economically significant rules," and the Regulatory Flexibility Act, which requires agencies to submit a regulatory flexibility analysis that describes the impact of the proposed rule on small entities.

Federal Register.⁵ The *Federal Register* publication invited the public to provide comments on all aspects of the proposed rule.

After considering over 75,000 public comments received on the proposed overtime rule, Labor revised the proposed changes, finalized the rule, and published a second impact study. For the final overtime rule, Labor increased the salary level below which workers would be guaranteed overtime to \$455 per week, and revised the proposed language of the duties tests for higher income workers.⁶ In April 2004, Labor published the final version of the overtime rule and the related impact study in the *Federal Register*.⁷ The updated rule went into effect in August 2004.

Labor contracted with CONSAD, an economic and public policy analysis consulting firm, to assist with estimating the impact of both the proposed and final overtime rule. Labor noted that it solicited bids from several contractors and chose CONSAD because the firm had the expertise and experience to do the work and was the low cost bidder. CONSAD officials pointed out that since the 1970s the firm has assisted federal agencies in creating impact studies for federal rules.

A general prohibition exists against contractors performing functions that are inherently governmental. Under guidance from the Office of Management and Budget, contractor services that relate to the development of regulations are not considered to be inherently governmental if agencies preserve appropriate control.

At the time the overtime rule was being updated and the impact studies were being conducted, there was no federal requirement that technical

⁵The proposed changes to the overtime rule, entitled “Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees” and information on the impact of these proposed changes were published in the *Federal Register* on March 31, 2003 (68 Fed. Reg. 15560). Throughout this report, we refer to all of the impact analyses presented in this *Federal Register* notice as Labor’s impact study on the proposed rule.

⁶Similar to the overtime rule in effect in 2003, the updated overtime rule’s salary level for guaranteed overtime is not indexed for inflation.

⁷The final version of the overtime rule and information on the impact of the final rule were published in the *Federal Register* on April 23, 2004 (69 Fed. Reg. 22122). Throughout this report, we refer to all of the impact analyses presented in this *Federal Register* notice as Labor’s impact study on the final rule.

material in impact studies be subject to a peer review by outside experts.⁸ Accordingly, the impact studies for the overtime rule were not given a peer review.⁹

Contracts Required CONSAD to Provide Technical and Analytic Support to Labor

CONSAD was responsible for providing technical and analytic support to assist Labor in estimating the impact of the updated overtime rule. Specifically, CONSAD was charged with supplying the “information, data, and economic” analyses that Labor needed to prepare the impact studies for the proposed and final overtime rule.

The contract for the proposed rule required CONSAD to produce various reports on the impact of the updated rule. For example, CONSAD was tasked with conducting a cost-benefit analysis for the rule, reporting on the impact of the rule on businesses as well as reporting on how the rule would affect state, local, and tribal governments. Although the contract did not specifically require CONSAD to analyze the impact of the proposed rule on workers, it did allow for “other economic reports and analyses.” According to both Labor and CONSAD, Labor asked CONSAD to estimate the number of workers who could gain or lose actual overtime pay under the proposed rule.

After CONSAD completed its work on the proposed overtime rule, Labor and CONSAD set up a second contract to allow for CONSAD to assist in studying the final overtime rule. For the final rule, CONSAD was required to provide a report to Labor estimating the number of workers affected by the changes to the overtime rule. In addition, the contract specified that CONSAD would profile the types of workers affected by the updated rule and provide details on them, including their ages, educational backgrounds, and occupations. The contract also required CONSAD to review public comments on the impact study for the proposed rule. A Labor official noted that the contract for the work on the final rule was more detailed than the contract for the proposed rule, because the agency

⁸The Office of Management and Budget has since issued guidance to federal agencies requiring peer review of important scientific information distributed by the federal government, including the models used in regulatory impact analyses. See Office of Management and Budget, *Final Information Quality Bulletin for Peer Review* (Washington, D.C.: Dec. 15, 2004).

⁹Labor noted that the Council of Economic Advisers and the Office of Management and Budget reviewed the impact study for the final overtime rule and furthermore, Labor pointed out that this review would have met many of the new peer review requirements had they been in effect at that time.

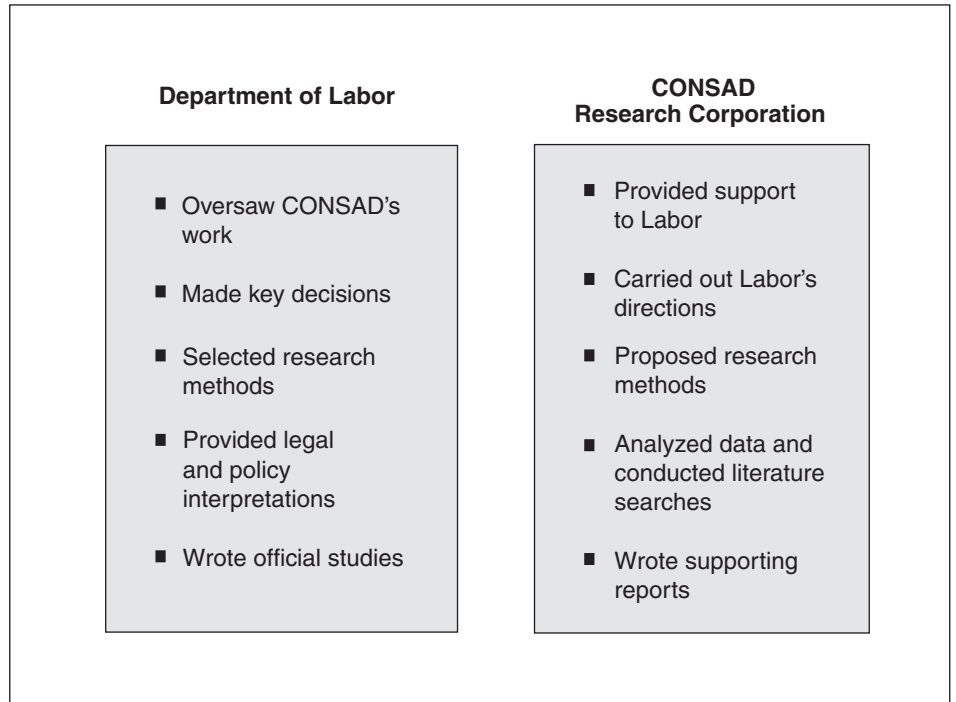
had more experience with the subject matter and had the benefit of thousands of public comments by the time it asked CONSAD to do this additional work.

Consistent with federal guidance, both contracts noted that Labor was responsible for overseeing CONSAD's work. Labor was responsible for approving the direction and scope of CONSAD's analyses. In addition, Labor had the authority to approve the specific methodologies used by CONSAD to collect and evaluate data. According to the contracts, CONSAD's performance would be evaluated in part on the contractor's responsiveness to Labor's directions.

While CONSAD Provided Support, Labor Made All Key Decisions in Impact Studies

CONSAD provided Labor with technical and analytic support in estimating the impact of the updated overtime rule. Consistent with federal requirements, Labor made all of the key decisions in the studies for the proposed and final overtime rule. Figure 1 presents the respective key responsibilities of both Labor and CONSAD in developing these impact studies for the overtime rule (see fig. 1).

Figure 1: Key Responsibilities of Labor and CONSAD in Creating the Impact Studies



Source: Labor and CONSAD officials.

Labor and CONSAD worked closely with one another during the studies of the proposed and final overtime rule. CONSAD conducted literature searches, proposed certain methods for conducting the impact studies, analyzed data, and wrote summary reports. In addition, during the development of the overtime rule, CONSAD served as a sounding board as Labor assessed the economic impacts of potential rule changes. Labor was developing the rule at the same time CONSAD was helping to measure its impact. As a result, the process can be characterized as quite dynamic, with Labor providing CONSAD with ongoing changes to the rule and Labor modifying both the proposed and final rule in response to CONSAD's analyses. For example, Labor tested several salary levels for guaranteed overtime during the rule-making process and changed the levels in response to data from CONSAD on the number of workers who would be affected. To facilitate this exchange of information, Labor and CONSAD communicated frequently in person or via telephone and e-mails and sent data spreadsheets back and forth.

Consistent with the contracts, Labor directed the impact studies and made the key methodological and data decisions. For example, Labor instructed CONSAD to estimate the impact of the updated overtime rule by looking at data on workers' wages and occupations. CONSAD then performed analytic tasks in response to Labor's direction and made modifications as needed in response to Labor's requests.

Labor also provided CONSAD with all of the legal and policy interpretations underlying the impact studies. For example, Labor informed CONSAD that certain workers—including federal employees, self-employed workers, and clergy—were not covered by the FLSA and therefore were not entitled to overtime pay. Additionally, Labor provided CONSAD with the agency's interpretations of the updated rule's duties tests and explained to CONSAD how the agency would enforce these tests. CONSAD used this information to help estimate the impact of the updated overtime rule on workers.

Although Labor had key decision-making authority in the impact studies for both the proposed and final overtime rule, it played a much more "hands-on" role in estimating the impact of the final rule. According to Labor, the agency had additional staff resources available to assist with the final impact study.

CONSAD produced two formal reports, one summing up its work with Labor on the proposed overtime rule and the other documenting its work with Labor on the final rule. In addition to covering topics such as the impact of the rule on businesses, both products described the effect of the updated rule on workers. The reports, however, varied in how they summarized the number of workers affected by the rule change. For example, the CONSAD report on the proposed rule used ranges to show the minimum and maximum number of workers affected by certain provisions of the rule. In contrast, the CONSAD report on the final rule used specific numbers to estimate the effect of the rule change on these workers. According to Labor, this shift from using ranges to using specific numbers to report the impact of the rule on workers was due to methodological differences between the study of the proposed rule and the study of the final rule. Labor noted that the agency decided to change

methodologies due to technical concerns and was interested in improving the accuracy of the resulting estimates.¹⁰

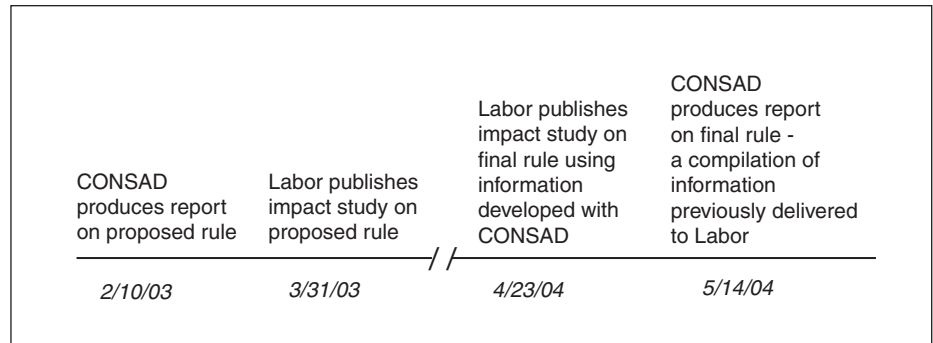
In addition to providing Labor with these reports, CONSAD reviewed some public comments on the proposed rule. Specifically, CONSAD reviewed public comments that critiqued the impact study for the proposed rule on technical grounds. As part of its review of these public comments, CONSAD examined a critique submitted by the Economic Policy Institute (EPI). CONSAD officials then held discussions with Labor regarding the methodological issues raised by the EPI critique. CONSAD noted that it did not provide any quantitative analysis to Labor regarding the EPI critique.¹¹ In response to the entire range of public comments on the proposed rule, Labor modified the final overtime rule and the impact study for the final rule.

Labor officials wrote the impact studies published in the *Federal Register*. Portions of these studies were based on the analyses Labor had developed with CONSAD (see fig. 2 for timeline of studies and related CONSAD reports). Although Labor's impact study for the proposed rule included some information on the rule's impact on workers, it focused primarily on the impact on businesses and government. However, the study did note that readers could contact Labor to obtain a related report with additional information. In response to such requests, the agency provided copies of the CONSAD report on the proposed rule, which included more details on the impact of the proposed rule on workers.

¹⁰For Labor's full description of the change in methodologies, see the *Federal Register* on April 23, 2004 [69 Fed. Reg. 22201].

¹¹The EPI critique discussed the difference between measuring the impact of the updated overtime rule in terms of the actual number of workers whose paychecks would be affected and measuring it in terms of the number of workers whose broader rights to overtime protection would be affected even if they currently do not work more than 40 hours a week. According to both Labor and CONSAD, CONSAD did not provide Labor with a ratio estimating the number of workers whose paychecks would be affected to the number of workers whose overtime rights would be affected by the updated rule.

Figure 2: Timeline for CONSAD’s Reports and Labor’s Impact Studies for the Updated Overtime Rule



Source: GAO analysis of CONSAD’s reports and Labor’s studies.

For the impact study on the final overtime rule, Labor presented a much more detailed analysis, focusing in large part on the impact of the rule on workers. Although Labor published this impact study in the *Federal Register* before it received the CONSAD report on the final rule, much of the information in the CONSAD report had already been delivered to Labor, and the final CONSAD report simply compiled this information into one document.

For the CONSAD reports and the impact studies Labor published in the *Federal Register*, Labor noted it was responsible for creating the numbers that estimated the impact of the updated overtime rule on workers. Consistent with federal requirements, Labor stated that it directed, reviewed and approved of the process for calculating these numbers.

Agency Comments and Our Evaluation

We provided a draft of this report to Labor for review and comment. Labor noted that it concurred with our report. Labor's official comments are reproduced in enclosure I. Labor also provided technical comments that we incorporated where appropriate.

As we agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of this report until 30 days after its date. At that time, we will send copies to the Department of Labor and other interested parties. In addition, this report will be available at no charge on GAO’s Web site at <http://www.gao.gov>.

Please contact me on (202) 512-7215 or robertsonr@gao.gov, if you or your staff have any questions about this letter. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure II.

Sincerely yours,

A handwritten signature in black ink that reads "Robert Robertson". The signature is written in a cursive style with a large, prominent initial "R".

Robert E. Robertson, Director
Education, Workforce, and Income Security Issues

Enclosures – II

Enclosure I: Comments from the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employment Standards
Washington, D.C. 20210

MAY 17 2005

Mr. Robert E. Robertson
Director, Education, Workforce,
and Income Security Issues
United States Government Accountability Office
Washington, D.C. 20548

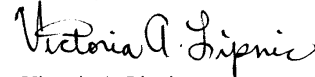
Dear Mr. Robertson:

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO) draft report, *Labor Made Key Decisions in Studies of Updated Overtime Rule and Contractor Provided Support*. We have provided some comments of a technical nature to GAO staff, and otherwise, concur with the report.

Anecdotal reports and press accounts published since the final overtime rule went into effect indicate that the basic conclusion of the economic analysis was correct, namely that millions of workers would gain overtime protection and very few, if any, would lose overtime protection.

The Department appreciates the opportunity to provide comments on this report.

Sincerely,



Victoria A. Lipnic

Enclosure II: GAO Contact and Staff Acknowledgments

GAO Contact

Robert E. Robertson (202) 512-7215

Acknowledgments

Brett Fallavollita, Assistant Director, and Melissa Emrey-Arras, Analyst in Charge, contributed significantly to all aspects of this report. In addition, Theresa Chen assisted in the design of the study and gathered information for our findings. Richard Burkard, James Rebbe and Sheila McCoy provided legal support, while Kenneth Bombara helped the team understand the impact analyses. Corinna Nicolaou assisted the team in writing the report.

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