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United States Government Accountability Office
Washington, DC 20548

September 29, 2008

Mr. James R. Davey
3720 W. Rosamund Avenue
Spokane, WA 99224

Dear Mr. Davey:

This letter responds to your correspondence last September with GAO officials about concerns with overcharging labor costs by federal government contractors. Your concerns were based on your interpretation that Public Law 99-272 justifies the need for legislation to similarly revise the method of computing hourly rates of pay for white-collar employees of federal contractors that are used to bill the government.

Hourly Pay Rate Computation of Federal Salaried (White-Collar) Employees

The Congress passed the Federal Employees Pay Act of 1945 (5 U.S.C. § 5504) to (1) simplify payroll procedures and computations and (2) correct inequities in the method used to pay overtime to white-collar salaried (as opposed to federal blue-collar, i.e., hourly wage-grade) employees. The objectives were to establish pay administration policies that would be uniform for federal white-collar employees and be consistent with procedures for federal blue-collar workers, who were authorized to work a basic 40-hour work week over a 52-week period, or 2,080 hours. As enacted, the law was very clear that annual salaries for federal white-collar employees would be based on 26 biweekly pay periods of 80 hours each and not on a calendar year. The law also established the following method for computing white-collar employees' biweekly pay:

- The annual salary was divided by 2,080 hours to determine an hourly rate, i.e., based on the 26 biweekly pay periods (over a 52-week year) X 80 hours of salary which totals 2,080 hours for annual pay.
- The hourly rate is rounded to the nearest cent.
- The hourly rate is multiplied by 80 hours to determine biweekly pay.

The legislation you cited in your correspondence (The Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. Law No. 99-272) permanently changed the method for converting federal white-collar employees' annual salary to hourly pay rates.¹

¹ § 15203, Pub. Law No. 99-272, enacted April 7, 1986.

According to the legislative history on this and related provisions that year, a range of budget and appropriations requirements to freeze, delay, and cap federal employee pay adjustments over fiscal years 1986 through 1988 were determined on the basis of concerns over the budget deficit.

Pub. Law No. 99-272 established that the annual salary be divided by 2,087 hours instead of the previous conversion that was based on 2,080 hours. All other methods for computing biweekly pay remained unchanged (that is, the hourly rate is rounded to the nearest cent and the hourly rate is multiplied by 80 hours to determine biweekly pay). The budget-cutting intent of establishing the 2,087 conversion factor was to not only reduce federal white-collar employees' hourly pay rates, but also in turn to permanently (1) reduce the cost of their annual compensation; (2) lower premium pay rates for overtime; and (3) reduce the government contribution for retirement.

Contractor Method for Computing Hourly Rates of Pay for Salaried (White-Collar) Employees

We disagree with your assertion that contractors overcharge the U.S. government hundreds of millions of dollars each year because they are allowed to use a payroll conversion factor for salaried (white-collar) contractor employees different from the 2,087-hour conversion method used to set hourly rates of pay for federal white-collar employees. Amounts billed to the government are based on contractors' costs, or what salaried employees earn (i.e., professional staff not normally eligible for overtime compensation). For example, a salaried employee earns \$2,000 for working a 40-hour week; the employee's hourly rate would be \$50 ($\$2,000 \div 40$ hours). To change the amount billed would require a change to what the employee earns and would result in salaried employees losing money in their earned pay. To do as you suggest would have the impact of seeking to save money from allowable contract costs by imposing the 2,087-hour method on contractors' compensation of salaried employees, as shown in the table below. This would result in a reduction of the salaried employees' annual income.

Illustrative Impact of Establishing the 2,087-Hour Conversion Factor on a Salaried (White-Collar) Contractor Employee

Illustrative annual salary (i.e., gross pay) for contractor employee	Hourly rate of pay if annual salary is divided by 2,080-hour method	Hourly rate of pay if annual salary is divided by 2,087-hour method	Annual gross pay earned over 52 weeks of 40 hours each using the 2,080 hour method	Annual gross pay earned over 52 weeks of 40 hours each using the 2,087-hour method	Amount of gross pay lost by contractor employee by using the 2,087-hour method
\$104,000	\$50.00	\$49.83	\$104,000	\$103,646.40	\$353.60

GAO's reviews have found that, with some exceptions, most contractors who have the Defense Contract Audit Agency approved payroll and billing systems use the 2,080-hour method for computing billable hourly rates of pay for exempt salaried employees not eligible for overtime compensation. This is the accepted basis, based on the standard that an annual salary is equal to 52 weeks X 40 hours = 2,080 total

hours. The use of this method for computing billable hourly rates is not prohibited by law or regulation.

In view of the issues raised above, we believe there is no need for legislation or other changes to revise the method of computing hourly rates of pay for white-collar employees of federal contractors in the manner which you describe. Congress, when drafting Pub. Law No. 99-272, made it applicable to Government employees only. Had Congress thought it necessary, they could have expanded its coverage to contractor employees as well. For whatever reason, Congress chose not to do so. Therefore, we see no basis for pursuing the matter further. Any questions in response to this letter may be directed to Carolyn Kirby, Assistant Director at (202) 512-9843.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Cristina T. Chaplain', with a long horizontal line extending to the right.

Cristina T. Chaplain
Director, Acquisition and Sourcing Management