

October 1995



Audit of Management and Operating Contractor Overtime Costs

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memorandum

DATE: October 27, 1995

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SUBJECT: INFORMATION: "Audit of Management and Operating Contractor
Overtime Costs"

TO: The Secretary

BACKGROUND:

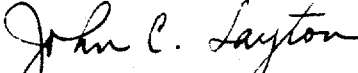
Management and operating contractor overtime costs totaled about \$251 million in Fiscal Year 1994. This included about \$65 million for exempt employees (higher-paid executives, administrative, or professional) and \$186 million for nonexempt employees. We conducted this audit to evaluate contractor overtime payments for compliance with applicable regulations and contract provisions.

DISCUSSION:

The Department's policy requires contractors with cost-type contracts to hold overtime to the minimum necessary to support mission requirements. However, an analysis of the 50 management and operating contracts that were in effect at the end of Fiscal Year 1994 and a detailed review at four of these contractors showed that the Department did not adequately monitor and manage contractor efforts to minimize overtime. We recommended a variety of cost reduction strategies including benchmarking contractor overtime policies and procedures against best practices in the private sector and prohibiting monetary payment to exempt employees for irregular and occasional overtime worked.

The Associate Deputy Secretary for Field Management and the Deputy Assistant Secretary for Procurement and Assistance Management did not specifically concur or nonconcur with the recommendations. However, they advised that a draft overtime policy has been designed to balance the need for reduced oversight against the need to demonstrate responsible stewardship of taxpayer dollars. The policy,

which will be implemented through a Contract Reform Rulemaking, specifies conditions that will trigger increased DOE oversight of contractor overtime by the Head of Contracting Activities.


John C. Layton
Inspector General

Attachment

cc: Deputy Secretary
Assistant Secretary for Human Resources and Administration
Director, Office of Contractor Human Resource Management
Director, Office of Resource Management and Services

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

AUDIT OF MANAGEMENT AND OPERATING
CONTRACTOR OVERTIME COSTS

Report No.: DOE/IG-0381
Date of Issue: October 27, 1995

Capital Regional Audit Office
Germantown, Maryland 20874

AUDIT OF MANAGEMENT AND OPERATING
CONTRACTOR OVERTIME COSTS

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U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES

AUDIT OF MANAGEMENT AND OPERATING
CONTRACTOR OVERTIME COSTS

Audit Report Number: DOE/IG-0381

SUMMARY

The Department of Energy uses contractors to operate its facilities. Management and operating contractor overtime costs totaled about \$251 million in Fiscal Year 1994. This included about \$65 million for exempt employees (higher-paid executives, administrative, or professional) and \$186 million for nonexempt employees.

The purpose of our audit was to evaluate contractor overtime payments for compliance with applicable regulations and contract provisions. Our objective was to determine whether the Department had controls in place to monitor and manage contractor overtime use.

In keeping with the Federal Government's efforts to reduce spending, the Department's policy requires contractors with cost-type contracts to hold overtime to the minimum necessary to support mission requirements. An analysis of the 50 management and operating contracts that were in effect at the end of Fiscal Year 1994 and a more detailed review at four of these contractors showed that the Department did not have adequate controls in place to monitor and manage contractor efforts to minimize overtime. Improving contract management and administration over contractor overtime could help reduce overtime costs.

We recommended a variety of cost reduction strategies including benchmarking contractor overtime policies and procedures against best practices in the private sector and prohibiting monetary payment to exempt employees for irregular and occasional overtime worked.

Management did not specifically concur or nonconcur with the finding and recommendations. Management commented that it had identified a need to implement an overtime policy that was consistent with contract reform initiatives and that balances the need for reduced oversight against the need to demonstrate

responsible stewardship of taxpayer dollars. A draft overtime policy that specifies conditions that will trigger increased DOE oversight of contractor overtime will be implemented through a consolidated Contract Reform Rulemaking.

Office of Inspector General
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PART I

APPROACH AND OVERVIEW

INTRODUCTION

The Department of Energy (Department) uses contractors to operate its facilities. During Fiscal Year 1994, the Department's management and operating contractors (contractors) had a total payroll of about \$6.6 billion. Of this amount, about \$251 million was compensation for overtime pay.

The purpose of our audit was to evaluate contractor overtime payments for compliance with applicable regulations and contract provisions. Our objective was to determine whether the Department had controls in place to monitor and manage contractor overtime use.

SCOPE AND METHODOLOGY

To accomplish our objective, we obtained the applicable contract provisions and the reported overtime costs for the 50 management and operating contracts that were in effect at the end of Fiscal Year 1994. Our audit included discussions at Departmental Headquarters of policies designed to control contractor overtime. These discussions were held with staff from both the Office of Resource Management and Services and Office of Contractor Human Resources Management. We reviewed applicable Federal and Departmental acquisition regulations and correspondence related to contractor overtime policies. We also reviewed related contractor internal audit reports and reports issued by the Office of Inspector General and the General Accounting Office.

Our analysis of the 50 contracts included:

- Determining what limitations on overtime pay were included in the provisions of each contract.
- Analyzing contract incentives such as consideration given to reducing overtime costs incurred in determining award fee.
- Determining whether budget limitations or ceilings on the amount of overtime allowed were established for use by contract administrators to limit costs.

- Evaluating use of compensatory time in lieu of monetary payment for irregular and occasional overtime worked by exempt employees.

We also judgmentally selected four contractors for more detailed review to evaluate controls over implementation of the Department's overtime policies. These reviews included discussions with responsible operations or field office staff and evaluations of the contractor's policies and procedures regarding overtime. As part of this evaluation of compliance with regulations and contract provisions, we examined employees' time and attendance records and justifications for overtime worked at the following contractor locations: Allied Signal in Kansas City, Missouri and Sandia National Laboratory, Ross Aviation, and Lovelace Biomedical Research Laboratory in Albuquerque, New Mexico.

Using a questionnaire, we obtained information from the operations/field offices on the amount of total contractor payroll and overtime payments. This information was used to compile comparative data on the changes in overtime pay between Fiscal Years 1993 and 1994. We did not test the validity of or rely on this computer-processed data to accomplish our objective.

The audit was made in accordance with generally accepted Government auditing standards for performance audits and included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. Accordingly, we assessed internal controls regarding overtime use. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed.

The audit was performed between March and July 1995 and covered contractor overtime for the 50 contracts in effect at the end of Fiscal Year 1994.

An exit conference was held with representatives of the Offices of Assistant Secretary for Human Resources and Administration and Associate Deputy Secretary for Field Management on September 19, 1995.

BACKGROUND

In acquiring the services of management and operating contractors, the Department uses cost reimbursable contracts. Under these contracts, the contractors are reimbursed for allowable costs incurred.

One of the major costs under these contracts is payroll which includes both regular and overtime pay. Contractor overtime costs remained relatively constant from Fiscal Year 1993 to Fiscal Year 1994. Total contractor overtime costs for Fiscal Years 1993 and 1994 were \$272 million and \$251 million, respectively. This reduction was primarily due to a \$16 million reduction by one contractor at Savannah River. Of the \$251 million paid in Fiscal Year 1994, about \$65 million was overtime pay to higher-paid executives, administrative, or professional personnel not subject to the Fair Labor Standards Act (Public Law 75-718 as amended) which addresses exempt employees. The other \$186 million was for employees subject to the Fair Labor Standards Act (nonexempt employees), who were generally paid for overtime at 1 1/2 to 2 times their hourly rate of basic pay.

In 1994 and 1995, the Office of Inspector General issued reports with recommendations designed to minimize overtime costs. These reports were:

- "Audit of the Management and Cost of the Department of Energy's Protective Forces," DOE/IG-0354, July 27, 1994.
- "Audit of Overtime Payments to Exempt Employees at the Savannah River Site," DOE/IG-0361, November 22, 1994.
- "Audit of Transportation Safeguards Division Courier's Work Schedules," WR-B-95-05, April 3, 1995.

OBSERVATIONS AND CONCLUSIONS

At a time when the Federal Government faces austere budgets, the Department did not adequately monitor and manage contractor overtime costs. We found that overtime compensation for nonexempt employees could be reduced by providing contractors with incentives to reduce overtime costs, establishing budget and/or ceiling limitations, and by modifying work schedules to reduce overtime requirements. Also, the Department could reduce contractor overtime pay by prohibiting monetary compensation to exempt employees for casual (occasional or irregular) overtime worked. For those unusual circumstances or events that would require exempt employees to work overtime, alternatives to paid overtime should be utilized.

Our review of the Personnel Appendices for the 50 contracts showed that additional controls were needed to limit overtime costs. Of the 50 contracts:

- 50 did not include specific incentives to reduce overtime costs;

- 42 did not require an approved budget by the contracting officer for overtime;
- 42 did not specify overtime ceiling limitations as to the amount of overtime allowed during the fiscal year; and
- 48 did not contain any provisions for utilizing alternatives to paid overtime such as compensatory time in lieu of monetary payment for exempt employees.

At a time when the Department is downsizing and its operations are being streamlined, implementing cost reduction initiatives to reduce contractor overtime would help in this process. This finding should be considered by management in preparing the yearend assurance memorandum on management controls.

Management developed a draft overtime policy that was designed to balance the need for reduced oversight against the need to demonstrate responsible stewardship of taxpayer dollars. This proposed policy specifies conditions that would trigger increased Departmental oversight, while giving contractors the ability to allocate resources to best fulfill their missions.

Part II of this report provides details on our finding and recommendations. Part III of this report includes detailed management and auditor comments.

PART II

FINDING AND RECOMMENDATIONS

Contractor Overtime

FINDING

The Department's policy is that use of overtime by its contractors will be judicious, cost effective, and necessary to support mission requirements. Contractors are to hold overtime to a minimum and use it only when essential work cannot be accomplished during regular working hours. However, the Department did not have contract administration mechanisms in place to adequately monitor and manage contractor overtime. Department contract terms regarding overtime controls were vague and efforts to manage overtime have been limited. Improving contract administration by benchmarking contractor policies and procedures against best practices in the private sector and prohibiting monetary payment to exempt employees for overtime worked would reduce costs.

RECOMMENDATIONS

We recommend that the Deputy Assistant Secretary for Procurement and Assistance Management, in conjunction with the managers of the Department operations offices and other field or site offices, increase contract administration; provide guidance; and take action to monitor overtime by:

1. Benchmarking Department contractor employees overtime policies and procedures against best practices in the private sector.
2. Evaluating contractors efforts to reduce overtime costs as part of the contractor performance evaluation process.
3. Establishing an annual detailed overtime budget and/or ceiling for contractors incurring significant overtime costs; budgets and/or ceilings should be based on an evaluation of such factors as mission need, personnel resource, and availability.
4. Ensuring that work schedules are structured so as to reflect actual work requirements, thereby precluding the necessity for excessive overtime costs.

5. Prohibiting monetary payments to exempt employees for casual overtime worked. For those unusual cases where exempt employees are required to work overtime, alternatives to paid overtime should be utilized.
6. Requiring contracting officers to renegotiate existing contracts to include necessary contract clauses and controls regarding overtime.

MANAGEMENT REACTION

The Associate Deputy Secretary for Field Management and the Deputy Assistant Secretary for Procurement and Assistance Management did not specifically concur or nonconcur with the recommendations. However, comments were provided that principally discussed the draft overtime policy that will be implemented through a Contract Reform Rulemaking. This policy is designed to balance the need for reduced oversight against the need to demonstrate responsible stewardship of taxpayer dollars.

DETAILS OF FINDING

OVERTIME POLICY AND PRACTICES

The Secretary of Energy has encouraged Departmentwide benchmarking to reengineer and integrate management practices for continuous improvement. This technique ensures that Department performance mirrors the best practices of counterparts in the public and private sector. As a general rule, private industry does not compensate higher-paid employees for overtime. Also, some management and operating contractors either prohibit or limit paying overtime to upper management.

The Department's policy is that the use of overtime by contractors will be judicious and in support of the Department's mission requirements. Contractors are to balance the Departmental requirement for effective cost control with the need for efficient utilization of human resources and the need to ensure adequate compensation to recruit, retain, and motivate a competent contractor workforce.

This policy is expressed in the Department of Energy Acquisition Regulation (DEAR) which states that approval for overtime hours is justified only where it can be shown that the overtime is necessary for the accomplishment of Department objectives. It further requires the Department to establish controls to ensure that overtime worked is in the best interest

of the Government. In addition, the DEAR states that overtime premiums are allowable only to the extent provided in the contract or approved by the contracting officer. Detailed information on the allowability of overtime costs is contained in the Personnel Appendix of each of the Department's contracts.

Private sector practices in regard to overtime are indicated by national surveys. For example, independent national surveys by Wyatt Data Services and William M. Mercer (two surveys), conducted in 1992 and 1993 respectively, showed that exempt employees were generally not compensated for overtime. The Wyatt Data Services survey revealed 68.6 percent of 1,268 respondents did not pay exempt overtime to scientific and professional personnel. One of the William M. Mercer surveys disclosed that 64 percent of the 947 firms employing exempt finance, accounting, and legal professionals did not compensate those exempt employees for overtime. The second William M. Mercer survey which included information systems employees in the exempt category indicated that 64.7 percent of the 929 firms surveyed did not pay overtime to exempt employees.

MANAGEMENT OF OVERTIME

Department and contractor officials did not have controls in place to adequately monitor and manage overtime costs. We identified very few initiatives that would help manage and restrict the amount of overtime worked. We reviewed the Personnel Appendices of 50 contracts in effect during Fiscal Year 1994 to check for incentives to reduce overtime costs, budget and/or ceiling limitations, work schedules, and use of alternatives in lieu of monetary payment for exempt employees. The following paragraphs discuss what, if any, initiatives were found in the 50 contracts.

Contract Incentives

Contract incentives should encourage contractors to keep overtime to a minimum. None of the Fiscal Year 1994 contracts reviewed contained any type of incentives for contractors to reduce overtime use. However, one of the Department's contracts renewed in Fiscal Year 1995 provided an incentive by allowing additional award fee for a reduction in overtime costs below the previous year's amount.

Budget and Ceiling Limitations

Budget limitations and ceilings on the amount of overtime pay allowed would enable Department and contractor officials to better monitor and manage overtime. Of the 50 contracts reviewed, only 10 had overtime budgets or ceilings (6 contained

requirements for both an overtime budget and ceiling, 2 required an overtime budget, and 2 required an overtime ceiling). These budget and ceiling requirements differed among contracts. Some examples of the different requirements are:

- One contract required the contractor to submit an annual budget for overtime to the contracting officer for approval. Before the budgeted amount was exceeded, prior approval by the contracting officer was required.
- Another contract required contracting officer approval prior to the beginning of each fiscal year on the number of overtime hours and associated premium pay dollars budgeted by the contractor. Before exceeding these budgeted amounts (either hours or dollars) prior approval was required by the contracting officer.
- One contract imposed a ceiling calculated as 6 percent of the total salary cost as of September 30 of the preceding fiscal year.
- Two contracts limited the rate at which overtime was paid to exempt employees based on their monthly salary.

At the four contractor sites we visited, none of the contracts had budget or ceiling limitations.

Work Schedules

Occasionally employees' work requirements do not meet the traditional Monday through Friday workweek. In such cases, employees' workweeks may need to be altered to reflect actual work requirements. This serves to reduce the need for overtime paid at a premium rate. For example, a previous Inspector General report, "Audit of Transportation Safeguards Division Couriers' Work Schedules," dated April 1995, reported that the traditional Monday through Friday workweek did not fit the courier's current job requirements and recommended that a basic 40-hour workweek be established to correspond with the courier's actual work requirements.

At the four contractors we visited, one had established workweeks that accommodated the necessary weekend work. In contrast, another contractor scheduled maintenance employees to work the traditional Monday through Friday workweek with these employees also regularly scheduled to work overtime on the weekends. For this weekend overtime, the employees were paid

1 1/2 to 2 times their hourly rate. The majority of the overtime was for maintenance work that could not be performed during the week while regularly scheduled employees were in the plant. Since the work requirements necessitated employees to regularly work weekends, the workweek should have been changed, in our judgment, to reflect actual work requirements in order to avoid overtime costs.

Alternatives for Exempt Overtime

The Fair Labor Standards Act (Public Law 75-718 as amended) is silent on overtime compensation for exempt employees. The basic principle is that exempt employees are salaried rather than hourly workers. Thus, they are compensated for completing their work assignment as a package rather than receiving hourly compensation. In Fiscal Year 1994, Departmental overtime pay to exempt contractor employees totaled about \$65 million. Our review of the 50 contracts showed that:

- 14 contracts had a provision to prohibit payment for casual overtime and only compensated exempt employees for unusual or urgent conditions. For example, 3 of these 14 contracts stated that since exempt employees were paid a basic salary commensurate with certain job duties and responsibilities and not based on the actual hours worked, job requirements must be fulfilled regardless of the number of hours worked.
- 9 contracts had a clause that prohibited payment for casual overtime worked unless the exempt employee was working an extended work week.
- 15 contracts had provisions that placed limits on overtime payments depending on the employees grade or salary level.
- 9 contracts did not specifically address exempt overtime compensation.
- 2 contracts had no provisions for utilizing compensatory time in lieu of monetary payment.
- 1 contract permitted payments for casual overtime with prior contracting officer approval.

If the Department had followed the practice most commonly used in the private sector and had prohibited overtime pay to exempt employees for casual overtime or required contractors to

utilize alternatives, such as compensatory time in those unusual circumstances or events, overtime savings could have been achieved. However, management did not believe that prohibiting payment of overtime to exempt employees was feasible and was concerned with the practice of establishing one stringent overtime policy for all contractors. Management believed that, consistent with contract reform, contractors should be empowered with more responsibility and less oversight from the Department.

We recognize the Department's attempts to empower its contractors and we subscribe to the notion that policies may have to be structured to reflect local differences in site operations. However, we believe that under normal circumstances exempt employees should not be paid for overtime worked. As noted previously, national surveys reported that most private firms do not pay exempt employees overtime, but feel that salaried employees are paid to get a job done, not paid based on the number of hours worked to accomplish the job. Given the financial and budget situation of the Federal Government, and the Department in particular, it would be prudent to establish a Departmentwide policy to prohibit payment of overtime to exempt employees, using the private sector experience as a benchmark.

DEPARTMENT EFFORTS TO CONTROL OVERTIME

The audit disclosed that the Department's policies regarding monitoring and managing contractor employee overtime were limited and vague. The DEAR policies on overtime do not provide mechanisms to reduce overtime costs such as budget and/or ceiling limitations, workweeks that reflect actual work requirements, and alternatives to paid overtime for exempt employees. Because the Department does not have a comprehensive contractor overtime policy and contract provisions were not specific, required data needed by contracting officers to properly monitor and manage overtime was not available.

Further, at the sites we visited, the contracting officers had little involvement with monitoring overtime. One contracting officer stated he did not manage contractor overtime because the three contracts he was responsible for did not require him to approve an overtime budget. This led us to conclude that the Department's efforts to manage and reduce overtime costs were not adequate under the circumstances.

RESULTS OF DEPARTMENT EFFORTS

The Department did not have adequate assurance that the \$251 million paid to contractors for overtime in Fiscal Year 1994 was necessary, cost effective, and in support of Department mission requirements. Contractor overtime costs could be reduced

by providing adequate contract administration through the implementation of a variety of cost reduction strategies, including providing contractors with incentives to reduce overtime costs, establishing budget and/or ceiling limitations, and requiring workweeks that reflect actual work requirements.

Also, savings could be achieved if the Department prohibited monetary payment for overtime to exempt employees. The Department paid \$65 million in Fiscal Year 1994 to exempt employees.

PART III

MANAGEMENT AND AUDITOR COMMENTS

In response to this report, the Associate Deputy Secretary for Field Management and the Deputy Assistant Secretary for Procurement and Assistance Management did not specifically concur or nonconcur with the recommendations. A summary of management's comments and our response follows.

Recommendation. Require that the Deputy Assistant Secretary for Procurement and Assistance Management, in conjunction with the managers of the Department operations offices and other field or site offices increase contract administration; provide guidance; and take action to monitor overtime by (1) benchmarking contractor policies against best practices in the private sector; (2) evaluating contractor efforts to reduce overtime as part of the contractor performance evaluation process; (3) establishing annual overtime budgets and/or ceilings; (4) ensuring work schedules reflect work requirements; (5) prohibiting monetary payments to exempt employees; and (6) renegotiating existing contracts to include necessary controls regarding overtime.

Management Comments. Management stated that in light of the Department's current operating environment and mandates established by the Administration, the Department's overtime policy for contractors must ensure superior stewardship of resources while providing the correct level of supervision, responsibility, and accountability. Under the Department's contract reform initiatives, contractor overtime policy must have the flexibility to work with all other compensation issues, overall Departmental contracting policy, and give contractors the ability to allocate resources to best fulfill their mission requirements. The Department must ensure a contractor management control system that promotes mission accomplishment, and reduces administrative burden, while keeping the public trust.

Management also stated that the report does not make a case that a major problem exists with contractor use of overtime, because the report did not provide references to private industry overtime usage rates or rates for other Government agencies with similar contracts that would provide an appropriate reference. Further, management noted that the report did not address the decrease in contractor overtime use. From calendar year 1991 through 1994, the cost of overtime use by the Department's contractors decreased from \$357 million to \$285 million--a reduction of over 20 percent. Without the proper context, these figures are still quite large until compared to the contractors' base pay in calendar year 1991 and calendar year 1994, which was

\$6.0 billion and \$6.3 billion, respectively. The Department's contractor overtime rate was 6 percent in calendar year 1991 and 4.5 percent in calendar year 1994--a significant downward trend.

Finally, management stated that the recommendation to prohibit payments to exempt employees for overtime has little supporting documentation. The Secretary of Energy has encouraged the Department to operate under corporate best practices. The report cited national surveys that showed that 65 percent of corporations do not pay exempt employees overtime. Management stated that the operating practice of the majority should not necessarily be construed as the "best practice."

A draft policy developed as part of the contract reform initiative specifies certain conditions that will trigger increased Department oversight of contractor overtime. The policy requires a contractor to develop an overtime control plan and report semi-annually only when: (1) the contractor's overtime usage as a percentage of payroll exceeds the Department median overtime usage plus X percent or (2) the contractor's overtime usage as a percentage of payroll exceeds the Department median, and contractor policy provides for either overtime premium pay for exempt employees earning more than \$45,000 per annum, or overtime premium pay on any other basis than for hours worked in excess of 40 hours per week. This draft policy will be implemented through a consolidated Contract Reform Rulemaking currently under development. Publication of the draft Contract Reform Rulemaking will be in the Federal Register and is expected by December 31, 1995. Based on public comments, the Department will make appropriate changes to the policy.

Auditor Comments. Management's comments are partially responsive to the report and the intent of the recommendations. We feel that the lack of mechanisms to control the expenditure of funds on contractor overtime was a significant problem for the Department because of the magnitude of spending on contractor overtime. The audit methodology was to evaluate the current control environment and contractor overtime costs. The fact that contractor overtime costs had decreased over time, as positive as it might be, does not negate the need for mechanisms that will minimize contractor overtime in the future.

The report presented information on the prevalent overtime practices of corporations as reported in national surveys. We know of no Government agencies, in a significant restructuring mode, with similar contracts that could be compared to the Department of Energy. We felt that benchmarking contractor overtime to private practice was in line with the Secretary of Energy's initiatives to use benchmarking to reengineer and integrate management practices for continuous improvement. As

cited in our report, the national surveys show that most private firms do not pay overtime to exempt employees. Since those firms generally operate in a manner that is designed to further their own interests, we concluded that the prevalent practice of not paying overtime to exempt employees should be considered the "best practice."

Under the proposed draft policy using the contractor median overtime usage plus an undetermined percentage, contractors with the largest amount of overtime would be targeted for oversight of overtime. We consider this approach to be responsive to the recommendation if the percentage determined in the rulemaking process is low enough to establish meaningful performance expectations or benchmarks based on best practices in the private sector. We feel strongly, however, that the contractor overtime control plans should limit the circumstances under which exempt employees earn overtime pay.

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