

## SELECTED AREAS OF COST

### Chapter 44 – Accounting for Lump-Sum Wages Resulting from Union Contracts

#### Authoritative Sources

GAAP - Emerging Issues Task Force Issue Summary No. 88-23 Lump-Sum Payments Under Union Contracts

This chapter provides audit guidance on the proper accounting for lump-sum wage payments resulting from union contracts. Union contracts may provide that union member employees receive a lump-sum payment in lieu of or in addition to an increase in their base wage rate. The specific terms of lump-sum payments may vary, but ordinarily the employee is not required to refund to the company any portion of the payment if the employee terminates employment prior to the end of the contract period.

This chapter addresses the following topics:

44-1 Future Benefit of Lump-Sum Payments

44-2 Multiple Lump-Sum Payments

44-3 Effect of Delay in Union Contract Execution

44-4 Accounting Change

#### 44-1 Future Benefit of Lump-Sum Payments

Neither the FAR, CAS, or Statements of Financial Accounting Standards (FAS) provide specific guidance on the accounting of lump-sum wages. The Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) released Issue Summary (EITFIS) No. 88-23 dated December 1988, "Lump-Sum Payments Under Union Contracts" which provides specific guidance regarding the accounting for lump-sum payments. In the absence of specific guidance in the FAR, CAS, or FAS, the EITFIS which interprets GAAP is the appropriate accounting guidance to follow.

EITFIS 88-23 concludes that lump-sum payments are similar to an intangible asset in that the payments provided to the individuals in the current period will benefit future periods in the form of reduced payroll expense. In addition, the EITFIS 88-23 notes that Accounting Principles Board (APB) Opinion No. 12 requires that amounts estimated to be paid under deferred compensation contracts with employees be accrued in a systematic and rational manner over the period of active employment beginning at the time the union contract is entered into. Although the lump-sum payments are generally made at the beginning of each year, they should receive similar treatment so that the

expense is recognized in a systematic and rational manner. EITFIS 88-23 concludes that since the current lump-sum payments clearly benefit future periods, the matching concept requires that they be deferred and amortized over the period benefited; e.g., the period covered by the union contract.

## **44-2 Multiple Lump-Sum Payments**

EITFIS 88-23 addresses a single lump-sum payment. What happens when the union contract requires multiple lump-sum payments to be made over the period of the union contract? Discussions with the FASB staff led to the conclusion that each payment should be amortized from the scheduled date of payment to the date of the next scheduled payment. For example, if the union contract requires three lump-sum payments to be made on October 1, 1990, 1991, and 1992, with the contract expiring on September 30, 1993, then the costs of the October 1, 1990 payment should be amortized from October 1, 1990 to September 30, 1991, the October 1, 1991 payment from October 1, 1991 to September 30, 1992, and the October 1, 1992 payment from October 1, 1992 to September 30, 1993.

## **44-3 Effect of Delay in Union Contract Execution**

A union contract may not be signed until sometime after the previous contract has expired. Generally, the new contract will be retroactive, with an effective date coinciding with the expiration date of the prior contract. In such cases, the employees will usually receive a lump-sum payment on the date the contract is signed, although the period covered by the contract begins some time earlier. The matching principles discussed in the previous paragraphs should also apply here; i.e., the lump-sum payments should be amortized over the period of the union contract. The question is whether the amortization period begins at the time the contract is executed or at the time it is effective. The key to answering this question is determining the time at which the liability constructively exists.

Statement of Financial Accounting Concepts (SFAC) No. 6 defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." When employees continue to work after the old union contract expires in anticipation of a new contract, the act of continuing to work may constitute the past event referenced in the SFAC. In some circumstances, by continuing to work, the employees are showing that they anticipate receiving some future benefit. Under these circumstances, it would be difficult for the contractor to avoid making payments (a future transfer of assets) to these employees, either in the form of lump-sum payments, cost of living adjustments, or other benefits. Finally, the probable future sacrifice of benefits would be the lump-sum payments, provided it can be reasonably forecasted that these payments will be included in the new union contract. Therefore, if it can be reasonably forecasted that the payments will be made, then the costs should be amortized over the union contract period beginning on the effective

date of the contract. Conversely, if it can be shown that future payments are not probable (e.g., lump-sum payments are not included in the union labor package, lump-sum payments are in dispute, or the union negotiating position includes elimination of the lump-sum payments), then a liability does not exist until the union contract is signed. Thus, if these conditions have been met, the lump-sum payments should be amortized over the period covering the date of contract execution through the date of contract expiration (or the date of the next scheduled payment in the case of multiple payments). The key factor is to determine if there was a prior expectation that the lump-sum payments would be included in the new union contract.

### **44-4 Accounting Change**

For those contractors whose accounting practice is to accrue the payments in advance or to expense the lump-sum when paid, a change from the current method to amortization over the union contract period constitutes a change in the method of assigning costs to cost accounting periods. The contractor is subject to the requirements of FAR 52.230-6, Administration of Cost Accounting Standards, including the preparation of a cost impact proposal for those contracts that contain this clause.