

DOCUMENT RESUME

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[Budgetary Impact and Accounting Treatment of Costs of New York City Labor Settlement]. GGD-78-98; B-185522. July 26, 1978. 9 pp. + enclosures (7 pp.).

Report to Sen. Harry F. Byrd, Jr.; by Elmer B. Staats, Comptroller General.

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Organization Concerned: Department of the Treasury; New York, NY.

Congressional Relevance: Sen. Harry F. Byrd, Jr.

The budgetary impact of a contract negotiated by New York City with a coalition of municipal unions was analyzed. City officials estimated the cost of the contract for the 2-year period covered at \$1.088 billion. The estimate was reasonable, but additional costs may be incurred for deferred wages to employees and if some unions receive a larger settlement. Concerns were expressed about the uncertainty of some elements in the funding of the contract settlement. Also, the planned use by the city of the 1978 surplus as a funding source is not in accordance with generally accepted accounting principles. Two significant matters of concern were: the contract may have a significant budgetary impact on the city after June 1980 since the salary levels on which wage increases will be applied will be much higher at the end of the period than they were at the beginning of the contract, and the city softened its position on fringe benefits (or givebacks) and conceded to return some of the givebacks which were reduced in previous negotiations. (HTW)

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

26 JUL 1978

B-185522
GG8-257

The Honorable Harry F. Byrd, Jr.
United States Senate

Dear Senator Byrd:

In your letter dated May 9, 1978, you requested that we analyze the budgetary impact of the settlement of New York City's recent negotiations with its labor unions.

On June 7 we furnished you a preliminary response which projected a settlement with all unions, following the pattern of the transit workers contract which had been negotiated in April. After the preparation of our letter, a coalition of municipal unions, representing the majority of city workers, negotiated their own contract.

Although the labor picture is still unsettled, in that the negotiated contracts have not yet been ratified by the unions' memberships and other unions are still negotiating, we nevertheless want to respond to your letter at this time. We believe the contract negotiated by the coalition will undoubtedly form the pattern for all other settlements. Further, we wish to bring to your attention two matters which concern us and which have not been given widespread attention. These involve the budgetary impact of these contracts in future periods and the restoration of give-backs previously won by the city.

TERMS OF AGREEMENT

On June 5, 1978, a tentative agreement was reached between the city and a coalition of municipal unions representing most of the city's work force, except for police and firefighters. This contract was subsequently reduced to writing on June 20. The agreement covers the city's 1979 and 1980 fiscal years (July 1, 1978 - June 30, 1980).

Its major terms are as follow :

- A 4-percent wage increase (minimum \$400) will be effective beginning October 1, 1978, and another 4-percent increase (minimum \$400) will be effective October 1, 1979.
- Cost of living increase I (COLA I) is to continue to be paid to workers in their paychecks and included in their base salary for

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fringe benefit and pension computation purposes. All workers will be paid COLA I at a rate of \$441 per annum. (While most workers were paid COLA I at this rate in the prior contract, some received it in somewhat higher or lower amounts). COLA I will also be included in employee's base salaries for the computation of the second 4-percent wage increase.

- Cost of living increase II (COLA II), paid in the previous contract in lump sum amounts, adjusted for the consumer price index, will be discontinued. Its effective rate at the end of the prior contract was \$882 per annum. Replacing it will be a cash payment of \$750 per annum, paid in the paychecks of employees at a rate of \$28.76 biweekly. These amounts will not be included in base pay for pension purposes. While COLA II was to be offset by savings or revenues generated through worker productivity, the cash payment will be paid without consideration of productivity.
- The requirement for documenting offsetting productivity savings for COLA II in the prior contract will be waived for the final payment due under that program (\$567 per employee).
- No additional reductions in fringe benefits (or givebacks) will take place.

City officials estimate the cost of the contract over the 2-year period as applied to all municipal workers will be \$1.088 billion.

About \$868 million of this amount represents added budget costs to the city which will have to be met by its own tax levy funds. The balance represents amounts chargeable to Federal and State reimbursable programs as well as additional pension costs the city will incur by virtue of this settlement. Our analysis of the city's estimates shows them to be reasonable. Enclosure I shows the city's estimate of cost by contract provision.

In addition to these costs, an arbitration board has recently decided that the city is also liable for approximately another \$200 million representing deferred wages to its employees. However, this will only be payable if certain conditions related to the city's fiscal stability are met. Further, the board ruled that these amounts will not have to be paid until after June 30, 1982.

Furthermore, the city may incur added costs if those unions not accepting the coalition agreement (police and firefighters) receive a larger settlement. In that case, uniformed employees presently covered by the coalition agreement could "reopen" their contract and demand greater benefits as well. Approximately 15,000 workers have the right to exercise this "me too" clause. On July 19, 1978, a settlement was reached between the police and the city which is reportedly consistent with the coalition agreement. We have not yet reviewed this contract.

FUNDING OF CONTRACT SETTLEMENT

The city's fiscal year 1979 executive budget indicates that \$617 million is available for labor settlements and other contingencies. The sources for that funding are as follows:

	<u>(millions)</u>
Amount already included in 4-year plan	\$138
Contribution by N.Y. State	100
Overestimate of pension cost included in 4-year plan	71
"Surplus" in current year's budget—1978	170
Additional revenues and underspending— 1979-80	<u>138</u>
Total	<u>\$617</u>

Now that a settlement has been reached which will result in total budgetary demands on the city of \$868 million, the city has indicated that the added cost of \$251 million will be funded as follows:

	<u>(millions)</u>
Additional "surplus" expected in 1978	\$ 46
Additional State aid	60
Additional savings and city actions—1979-80	<u>145</u>
Total	<u>\$251</u>

Although we have not examined this incremental funding for the wage settlement, we are concerned by the uncertainty of some elements in the original \$617 million funding. In our letter to you of June 7, 1978, we discussed these uncertainties and stated that we believe it is unwise to rely upon some of these uncertain sources to fund a wage settlement.

Use of the 1978 surplus as funding source
is not in accordance with generally
accepted accounting principles

You specifically asked that we look into the city's plan to utilize its 1978 "surplus" to fund this 1979-80 labor settlement and for our opinion as to whether this funding technique was in accordance with generally accepted accounting principles. 1/

The importance of your question, of course, lies in the fact that the city is functioning under strict annual financial plans, and so, charging the cost of this labor settlement totally to 1979 and 1980 would increase the deficit in those years and require the city to make offsetting budget cuts. On the other hand, if the city charged approximately \$220 million in expenses to 1978, that would substantially ease the budgetary pressures in 1979 and 1980 and obviate the need to make budget cuts to pay for this wage settlement.

In our opinion, the city's accounting treatment of the transaction is not in accordance with generally accepted accounting principles. The facts of the situation, as we see them, are as follows. In early April 1978, city officials indicated that they intended to use their 1978 underspending or surplus to provide some of the funding necessary to pay for the wage settlement which was being negotiated. At the time, however, it was not clear just what the surplus would be used for. The city's Deputy Mayor for Finance, had at one point, suggested the surplus might be used to pay for deferred cost of living adjustments. Subsequently, other city officials suggested the surplus might be used to pay for bonuses. During the course of all these discussions this issue had become a public one and was being explored in the local press in articles like "NYC AND UNIONS STUDY USING 78 SURPLUS". 2/

In addition to these discussions about what the so-called surplus would be used for, there were also discussions about how to arrange to use it. From an accounting standpoint this presented a problem. Some city officials initially suggested bringing forward the surplus into 1979 and using it as a revenue in that year. This idea was quickly rejected by the Special Deputy State Comptroller for New York City as not being in accordance with

1/ This surplus exists only under special accounting criteria in State law. According to generally accepted accounting principles, no surplus exists; in fact, a deficit resulted from 1978 operations and a very large cumulative deficit exists from previous years.

2/ New York Times, May 9, 1978.

generally accepted accounting principles. His conclusion was based on the fact that there was no true surplus, but one existed only after certain adjustments permitted by State law. In addition, the city has a large cumulative deficit so that, under generally accepted accounting principles, there were no available funds to bring forward to 1979. We believe the Special Deputy Comptroller's conclusions are sound.

Ultimately, this matter was resolved when the city and the unions agreed that of the \$1,500 cash payment (\$750 x 2 years) \$937.50 would be considered to have been earned in 1978 and charged to that year. Subsequently, this amount was changed to \$1,000. If the payment was considered earned by the employees in 1978, the accounting problem would be solved since the payment could then be properly accounted for as a 1978 expense.

City officials conferred with their certified public accountants and prepared a representation letter which stated that \$1,000 of the \$1,500 in cash payments had been earned by the employees in 1978 and that it was the city's intention to expense the payments against fiscal year 1978. The CPAs stated that, based on the city's representations as to when the payments were earned, the proposed accounting in their opinion would be in accordance with generally accepted accounting principles.

Our view of this transaction differs from that of the city and its CPAs. As set forth in a statement of the Accounting Principles Board, a basic feature of financial accounting is that it emphasizes the economic substance of events rather than their form. In this case, the parties publicly stated on several occasions their intention was to utilize the 1978 surplus thereby easing 1979 and 1980 budgetary pressures. They stated that they would do so by some appropriate accounting technique which they had not yet decided upon.

Therefore we believe the use of the surplus and the relief of budgetary pressure in 1979 and 1980 was the objective of the parties and that is the substance of the transaction. In our opinion, this cannot be overlooked in assessing the propriety of the accounting involved. Looking toward the substance of the transaction then, we can see no justification for charging it as a 1978 expense.

Beyond the question of substance over form, there is, in our opinion, another flaw in the justification for charging this as a 1978 expense. The agreement requires that for employees to be paid the full \$1,000 payment they must continue to work for the city during 1979 and part of 1980. This requirement clearly suggests that the employees have not earned the \$1,000 payment for services rendered in 1978, and therefore that expense should not be charged to 1978.

In arriving at our assessment of this transaction we were guided in part by some particularly germane comments made some years ago in an accounting research study. ^{1/} while the study does not have the force of accounting principles it is nevertheless part of the accounting profession's body of knowledge. The authors said in part:

"Unless accountants are forearmed, they could slip into acceptance of accounting 'principles' which are not independent expressions of the results of accounting considerations but instead simply validate the policies established in the field of collective bargaining."

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On July 17, 1978, we provided this section of the letter to the city for its review and comment. A copy of its comments is included as Enclosure III.

The city strongly disagrees with our opinion that its accounting for the costs of the labor settlement is not in accordance with generally accepted accounting principles. The city contends that budgetary relief for fiscal year 1979 and 1980 was only one of the effects of the settlement and not a primary objective as we contend.

The city's comments contain information which supports its accounting treatment of the labor settlement. According to the city, at meetings in early April, representatives of the Mayor's office expressed the city's intent to share part of the estimated statutory surplus with its employees, because the surplus was partially derived from increased employee productivity. The city states it was advised by its independent auditors that if payment to employees was earned and related to services provided in fiscal year 1978, the cost of that payment should be charged to 1978. The city maintains that since this was its intent, negotiating this concept with the unions was the problem it faced and not accounting for the transaction.

We recognize that payment for services rendered in a given fiscal year is an appropriate expense of that year. We nonetheless continue to believe that the size of the labor settlement coupled with the financial difficulties faced by the city and its need to ease budgetary pressures in fiscal years 1979 and 1980 were the motivating forces in arriving at the terms of the labor settlement. While relieving an immediate fiscal problem, this strategy

^{1/} Accounting Research Study 3 "A Tentative Set of Broad Accounting Principles For Business Enterprises", by Robert T. Sprouse, Ph.D., and Maurice Moonitz, Ph.D., CPA.

compounds the financial pressures the city faces in the years beyond this contract. As a result, we feel strongly that charging part of the wage settlement to fiscal year 1978, a year in which the city anticipates a deficit under generally accepted accounting principles, not a surplus, obscures the impact of the settlement and will distort the results of the city's financial operations in fiscal year 1979 and 1980.

The overriding consideration from an accounting point of view is that under the terms of the labor agreement there is no liability for fiscal year 1978. The \$1,000 payment is, in effect, for services to be rendered in fiscal year 1979 and part of fiscal year 1980, subject to the condition that the employee worked in fiscal year 1978. This amount was not earned in fiscal year 1978, because employees who do not work in fiscal years 1979 and 1980 are not entitled to the payment.

BUDGETARY IMPACT OF CONTRACT IN FUTURE PERIODS

Generally speaking, this labor settlement has been presented as a conservative one. There is one aspect of it, however, which has not been widely discussed and which may not ultimately prove to be so conservative.

This contract may have a significant budgetary impact on the city after June 1980 since the salary levels on which wage increases will be applied will be sharply higher at the end of the period than they were at the beginning of this contract (see Enclosure II). This difference between the so called "going-in" and "going-out" rates is significant when viewed in terms of the next labor negotiation. For example, in this contract the employees won two increases of 4 percent each and these were viewed as moderate. At the end of the contract period, however, the full 8 percent will be in effect, and combined with the \$750 annual cash payment provided for in the contract, this will give the employees a "going-out" rate which may be as high as 16 percent more than the "going-in" rate for the average employee (\$15,500 per year). This increased rate will most likely become the base for the next negotiation and should have a budgetary impact not readily apparent when one examines the modest 4 percent increase in the contract at hand.

We discussed this with city officials who said there is no reason to assume that the \$750 annual cash payment in this contract will be included in the going-out rates on which future increases will be based. They maintain this will be a matter for negotiation. In fact, they do not assume the payment itself will be continued beyond 1980. Therefore, the financial plan for 1981 and 1982 makes no provision for paying the approximately \$160 million this payment would cost in each of these 2 years.

Union representatives, on the other hand, tell us their position will likely be that these amounts will be part of the base at which new negotiations will begin.

In our opinion, it is unrealistic to think otherwise.

RESTORATION OF GIVEBACKS PREVIOUSLY
WON BY THE CITY

One other aspect of this contract which has not been widely discussed, but which may nevertheless be significant, relates to the question of givebacks previously won by the city.

Early in the fiscal crisis the city negotiated a \$24 million annual reduction in fringe benefits with its unions. This was part of the general austerity program in the city and was one of the city's budget cutting actions. Under this program the starting salaries of certain new employees were cut back 10 percent; vacation allowances for new employees were reduced from 20 to 15 days; check cashing privileges were cancelled; and other fringes were either cut back or cancelled.

Going into this current negotiation, city officials had announced that they were demanding further reductions in employee fringe benefits, or givebacks, ranging from \$70 to \$100 million. As the negotiations progressed, however, the city softened its position on this matter and ultimately achieved no givebacks. Beyond that, the city also conceded to return some of the givebacks previously negotiated.

The 10 percent starting salary reductions and the vacation reductions were given back to the unions. We have not estimated the cost of the fringes returned, but city officials agree that the major concessions previously won from the unions have been returned.

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As arranged with your office, we are sending copies of this report to the Chairman of the Senate Committee on Banking, Housing and Urban Affairs and the Chairman of the House Subcommittee on Economic Stabilization, Committee on Banking, Finance and Urban Affairs. Copies will also be available to other interested parties who request them.

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We would be happy to meet with you or any of your staff members to discuss these issues further.

Sincerely yours,

A handwritten signature in cursive script that reads "Thomas B. Staats". The signature is written in dark ink and is positioned above the printed name and title.

Comptroller General
of the United States