Paying "Current" Versus "In Arrears"

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You may have come across the term "paid in arrears" or heard it in your workplace, but what does it mean? Also, what is the benefit of paying in arrears or paying “current” instead?

There are a lot of misconceptions regarding these two methods of paying employees, so one good way to understand the difference is with a couple of scenarios.

Paying “Current”

In our setting, we have an employer that has established a Monday-through-Sunday workweek for federal Fair Labor Standards Act purposes. This company’s management team intends to distribute paychecks to non-exempt employees each Friday afternoon for the workweek that began on Monday.

However, to have paychecks ready by Friday afternoon, the employer must process them ahead of time. Consequently, when these paychecks are prepared, supervisors do not yet know what an employee's actual hours worked will be for that workweek. This is where the tedious and manual work comes into play. For instance, maybe the employee ends up working more or less than the scheduled worktime on Friday, and/or maybe she works on the Saturday or Sunday of that workweek.

The employer resolves this situation by assuming that the employee will work the scheduled hours or a projected number of hours and computes her pay accordingly. If it turns out that she worked a different number of hours in that workweek, the employer makes the necessary adjustment (to add or subtract pay) in the next Friday's paycheck. This is frequently referred to as paying "current".

"In Arrears" Pay

The team “arrears” is used to describe a debt that is missing payment. When your company pays you in arrears, this means you are receiving your paycheck for work that you have already performed (so the company is indebted to you for that work).

In scenario number two, let us assume that, instead, this employer distributes the paychecks for the workweek on the following Friday. Meaning that they now pay seven days later than in the above situation. At the time the employer prepares those payments, it knows exactly what the employee's total hours worked were for the workweek that ended on the preceding Sunday. There is no built-in need for assumptions, guesstimates, or future corrections.

On the contrary, the payroll team can compute her wages accurately and can give her a paycheck that accurately represents her actual wages due for that workweek. Nonetheless, simply because the wages due were paid after the close of the workweek to which the pay relates, some refer to this approach as somehow representing payment "in arrears".

Which Method is Best?

As with many topics in the human resources and payroll world, what is “best” depends on your specific organization and workforce. As an employer, you should of course be sure that how often and when you pay employees are consistent with the requirements of all applicable laws, including those of state and local jurisdictions.

Many employers prefer to pay in arrears because there is a less risk for them overall. From the employee perspective, this is also a plus because your employees are assured to get paid for the work that they complete but also allows you as the employer to hold on to your cash a bit longer. So it is a Win/Win!

Transitioning to Paying In Arrears

As you can imagine, changing from paying current to paying in arrears can be a tricky process to maneuver. Switching from current to arrears has very big implications for employees as they would go one or two weeks without pay until they get paid under the new arrears method. To alleviate this hardship, you can cover the pay gap as a pay advance or allow your employees to use accrued time off.

Many employers will keep track of employees they pay an advance and withhold the advance from the employee’s final pay check. Any new employees would be started in arrears and would not need the adjustment to their final check. Another option is to reduce what the employee has to pay back based on how long they stay with your organization. For example, you could reduce their amount owed by 1 day per 1 year of service, which means in 5 years they have paid back the advance and you would no longer need to track.

As with any change, communication is vital to assure that your employees know of the changes will in advance and can prepare for any financial hardship that they might face. Below is a sample Memorandum that might be helpful if your organization is thinking of making a shift from paying current to paying in arrears.

MEMORANDUM

To: All Staff

From: Management

Re: Change in Pay Week Effective July 1, 2017

Date: April__, 2017 [recommended to be sent 60-90 days prior to pay date change]

We will also be changing to payment fully in arrears in July 2017. You are currently paid one week in arrears and one week current, meaning that payroll is processed prior to the date you complete the work for which you are paid. For increased accuracy in your paychecks and to improve reporting finances, we will move to a system of paying both weeks fully in arrears in the future. Starting with the July 1, 2017 check, you will be paid one week in arrears and advanced an additional week of pay, even though it was not actually earned, to avoid any cash flow hardship during the transition.

We will not adjust your pay for the July 1st check, you will be paid your normal amount instead of having your pay adjusted based on the pay period dates. This means that the organization will be advancing you an additional 5 days of pay, even though it was not actually earned, to avoid employee cash flow hardship during the transition.

If and when your employment with the organization ends, we will reduce your final check for the advancement of these additional 5 days of pay from your final paycheck. Over the next 5 years we will phase out 1 day owed the organization per year. Below is the schedule of the reductions:

2017 – 5 days reduced from your final paycheck
2018 – 4 days reduced from your final paycheck
2019 – 3 days reduced from your final paycheck
2020 – 2 day reduced from your final paycheck
2021 – 1 days reduced from your final paycheck
2022 – 0 days reduced from your final paycheck

Below is a summary of the pay dates and pay periods during this transition period.

Pay Date	Pay Period
July 1, 2017	June 12 through June 25 (one week in arrears plus an additional week's pay, totaling two weeks of gross pay)
July 15, 2017	June 26 through July 9 (two weeks fully paid in arrears)
July 29, 2017 and	July 10 through July 23 paid in arrears going forward

Please sign and return this form to the Payroll Department that you understand the impact on your final check. Please contact the Payroll Department at ______________ if you have questions or concerns about this change.