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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

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D-162517



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The Honorable
The Secretary of Defense

Dear Mr. Secretary:

We believe that you will be interested in a method of improving cash management in the Department of Defense and reducing the cost of Government borrowing. The basic concept is to delay disbursements from the United States Treasury to take greater advantage of the time value of money by converting from a "checks-written" basis to a "checks-paid" basis for reimbursing contractors for their expenditures. One of the most likely situations where this technique can be applied is in the Army's reimbursement of contractors for expenses incurred in operating Government ammunition plants. There are 26 such Government-owned contractor-operated (GOCO) plants.

HOW IT WORKS NOW (CHECKS-WRITTEN)

There is an Army disbursing officer at each of the GOCO plants. Once a week, or more often if necessary, the contractor presents a voucher to the disbursing officer for payment. This voucher is supported by a listing of checks the contractor intends to issue and, after appropriate review, the disbursing officer issues the contractor a Treasury check for the total amount of the voucher. The contractor then mails checks to the payees and deposits the Treasury check in its checking account.

Within a day or so the Treasury check is processed with a reduction in the U.S. Treasury balance while the contractor's individual checks are still unpaid. They are generally "floating" in the banking system for 3 or more additional days. The time value of money (interest) is represented by the period of time between when a Treasury check is deposited and when the contractor's checks are cleared and deducted from the contractor's account.

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Because of the high dollar amounts of the Treasury checks and the time it takes for contractors' checks to clear for payment, a substantial amount of Government funds is available on an interest-free basis to the contractors' banks. This increases funds borrowed by the U.S. Treasury and unnecessarily increases costs to the Government.

HOW IT MIGHT WORK (CHECKS-PAID)

The procedures for approving the checks that a contractor intends to issue could remain essentially the same. Instead of issuing a Treasury check at the time a contractor's checks are mailed to the payees, however, the contractor's bank would not receive Government funds until the contractor's checks were presented for payment. This technique is called a "checks-paid" letter-of-credit method of reimbursement. The "checks-paid" letter-of-credit method is used by the Energy Research and Development Administration (ERDA) which also manages GOCO plants. Some of these same plants engage in work for the Navy and the Navy also uses the "checks-paid" letter-of-credit procedures. This technique minimizes the amount of the "float" of Federal funds available to the commercial banking system because there is virtually no timelag between the drawdown from the Treasury and the payment by the bank. Correspondingly, interest expense to the Government is reduced as there is no need for the Government to borrow funds in advance of its actual needs.

POTENTIAL SAVINGS

We cannot precisely estimate the potential interest savings by using the "checks-paid" method because we examined bank balances at only 8 of the 26 GOCO plants. Further, the amount that bank balances for all plants could be reduced will depend upon the arrangements made with each bank. However, during a recent 3-month period, the eight Army GOCO plant banks had an average daily float of \$4.8 million which at 6 percent results in annual interest cost of about \$290,000. Since our review covered only eight of the Army's ammunition plants, the total savings should be significantly higher. The net savings would have to take into account any charges the banks might require as compensation for check cashing services and giving up the use of the "float" currently available.

CONCLUSIONS AND RECOMMENDATIONS

We believe use of the "checks-paid" letter-of-credit method, if used at Army ammunition GOCO plants, would result in improved cash management and significant savings to the Government. Initially, experimental use of this approach is

advisable to work out implementation problems, establish responsibilities, maintain necessary internal controls, and determine the impact on accounting procedures and other financial management operations. Experimentation with a procedure such as that used by ERDA may also show that it may have broader application for other operations throughout the Department of Defense.

We discussed the feasibility of this suggestion with representatives of the comptrollers' offices of DOD, Army, Navy, and Air Force. They agreed that our idea warrants further consideration.

We therefore recommend that the Secretary of Defense, in coordination with the Department of the Treasury, test the feasibility of using the "checks-paid" approach of cash management at selected GOCO plants. Also, we believe that if the letter-of-credit technique proves feasible at GOCO plants, consideration should be given to possible application in other Department of Defense cash management situations.

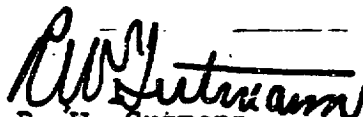
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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen of the House and Senate Committees on Appropriations, Armed Services, and Government Operations. We are also sending copies of this letter to the Secretary of the Army, the Secretary of the Treasury, and the Director, Energy Research and Development Administration.

We would appreciate receiving your comments on these matters and would be pleased to discuss any questions you may have.

Sincerely yours,


R. W. Gutmann
Director