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STATEMENT OF

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DIVISION DIRECTOR AND CHIEF ACCOUNTANT OF GAO
ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

BEFORE THE

SUBCOMMITTEE ON FEDERAL EXPENDITURES,
RESEARCH AND RULES

OF THE .

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

IMPROVING THE GOVERNMENT'S BILL PAYMENT PERFORMANCE

Mr. Chairman and Members of the Subcommittee:

It is our pleasure to appear before you today to discuss the Federal Government's bill payment performance and the potential impact of the legislation before you. The legislation would require the Federal Government to pay interest on overdue payments and to take early payment discounts only when timely payment is made. It would also provide for Congressional oversight of Federal bill payment performance.

GAO REVIEW OF GOVERNMENT BILL PAYING

As you know, over 3 years ago, we reviewed the Government's bill payment performance. We conducted this review

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because companies had complained that Federal agencies were slow in paying their bills. Some companies, it was said, did not seek Government business because of this. To determine how well the Government was doing as a bill payer and to identify any changes in policies or procedures that might be needed to improve the timeliness of payments, we analyzed a sample of contractor invoices, selected to be statistically representative of Government-wide payment performance. We also analyzed responses from 950 contractors to our questionnaire on payment performance of Federal agencies. In February 1978, we reported our findings in a report titled "The Federal Government's Bill Payment Performance Is Good But Should Be Better" (FGMSD-78-16). Also, in June 1977, we testified before the Senate Select Committee on Small Business on the problem of late payments by Federal agencies.

Payment Performance

Our review showed that Federal agencies were paying the majority of their invoices on time. Most companies, when questioned, said they were satisfied with how quickly they were paid. Only 16 percent indicated they were dissatisfied. However, some lengthy delays in payment did occur and were caused by contractors as well as by Federal agencies.

Our data, when adjusted for delays caused by contractors and other causes not attributable to Government agencies, showed that 70 percent of the Government's bills and 82 percent of the dollar total were paid within 30 days of the invoice date. Nearly 85 percent of the invoices and 98 percent of the dollar total were paid within 60 days. Our analysis also showed that irrespective of who caused the delay--the Government or the contractor--82 percent of the invoices representing 94 percent of the dollar value were paid within 30 days of the date of acceptance of the item by the Government.

There is no doubt that late payments cost contractors money. If the situation with respect to late payments is the same today as at the time of our review, applying an interest rate of 12 percent and assuming annual Federal procurements of $100 billion, we estimate that contractors may possibly be losing at least $ 150 million annually on late payments--the loss could be as high as $375 million. Delays in making payments also cost companies and the Government money in terms of additional time and effort spent tracking down unpaid invoices. The Government's opportunity to benefit from cash discounts is reduced with some contractors reporting they quit offering discounts because Federal agencies were not influenced to pay faster and because too many discounts were taken after the discount period had expired. Although our review did not cover this area, a Defense Department study indicated that delayed payments may also cause contractors to stop doing business with Federal agencies.

Reasons for Late Payments

Payments were delayed primarily because of the problems Federal payment centers had in obtaining all the paperwork needed to make payment. This paperwork comes from Federal buying and receiving activities and from contractors. The process of acknowledging receipt and acceptance of goods and services, and furnishing the required documents to the payment center were the greatest causes of delay. Contractors contributed to the problem by not always providing a correct invoice promptly to the right payment center. There were special payment procedures--commonly called fast pay procedures--that would eliminate some of the paperwork requirments, but Federal agencies were making little use of them.

Permeating the entire process was the lack of Federal standards establishing when payment was due. Government procurement regulations and the standard contract payment clauses did not specify due dates. Further, although most contractors' invoices included payment terms, the Federal procurement regulations were silent on whether agencies were required to abide by those terms.

One interesting observation from our study: Although 98 percent of the contractors responding to our questionnaire indicated that they considered payment to be due within 30 days from the invoice date, or sooner, only 69 percent cited this same period as an appropriate basis for determining that a payment is late. Twenty-seven percent of the firms said a payment is late when not paid within 60 days of the invoice date and the remaining 4 percent cited 90, 120, and even 150 days from the invoice date as a basis. When asked to compare the timeliness of Federal payments to payments from commercial firms, 43 percent of the contractors surveyed thought that commercial firms pay faster, 21 percent said commercial firms pay more slowly and 36 percent saw little difference.

Early Payment A Problem

While late payment was a problem, early payment of invoices was also a problem. Our review showed that the Government was paying 45 percent of its bills and 25 percent of the dollar total early. What's more, 19 percent of the bills were paid more than 15 days before due. As a result of paying its bills too early, the Government incurred unnecessary interest costs. Some companies even stopped offering discounts because they received payment fast enough without them. Applying the same analysis to early payments as we did to late payments, we estimate that the Government could avoid at least $900 million and as much as $3.8 billion in interest on its borrowings if all of the early payments are made exactly on the due date.

Report conclusions and recommendations

In making payments, Federal agencies have two obligations. They are required to pay bills when due, and at the same time must make sure they get what they pay for. Our study showed that Federal agencies were doing well in the latter respect. Agency payment procedures were aimed at making sure that goods and services were received in acceptable condition before paying contractor invoices. In addition, as I said before, the majority of Federal bills were paid on time, but there was room for improvement.

We concluded that improving Federal payment performance would require changes in Federal procurement policy and in agency payment procedures. We made a series of recommendations for speeding up payments, which, if carried out, would ensure that relatively few contractors would be paid late. For instance, we recommended that Federal agencies eliminate redundant steps in their payment process and make wider use of fast payment procedures whenever possible. We also recommended that Federal payment due date standards be developed and that Federal agencies, when it is practical, include specific payment terms in contracts and purchase orders. Finally, we called for the continual monitoring of Federal payment performance.

In a February 1980 report titled "Improving the Productivity of Federal Payment Centers Could Save Millions" (FGMSD-80-13), we again recommended actions for speeding up the Federal payment process. Some of the specific recommendations were for agencies to eliminate or consolidate payment centers which, due to low volume, cannot be made efficient and to hold receiving activities accountable for ensuring timely submission of receiving reports. In addition, we again recommended that agencies eliminate redundant steps in their payment process and avail themselves of fast payment procedures when possible.

ACTION TO STRENGTHEN THE GOVERNMENT'S BILL PAYING PERFORMANCE

In response to our 1978 report, the Treasury Department in May 1978, issued cash management regulations which required Federal agencies to make payments when due as specified in the invoice, contract, or other agreement and, if not specified, required payment on the 30th day from receipt of the invoice. As stated in our report, the absence of such standards had previously caused disagreements between Federal agencies and contractors on when payments were due. The regulations also provided for cash management monitoring by both the agencies and the Treasury.

Treasury subsequently reemphasized these requirements in letters to agency heads reminding them of the requirements to develop written cash management procedures and monitoring systems which provide for at least annual reviews of bill payment practices. Also, in a September 1980 letter, Treasury again reminded agency heads of the requirement to pay contractors when due, emphasizing that delays in payment create particular financial burdens for small and minority businesses.

In addition, the Office of Federal Procurement Policy of the Office of Management and Budget, in a November 1980 letter to agency heads, pointed out that, due to the current high borrowing rates, small firms were particularly vulnerable to late payment of their bills. The Office of Federal Procurement Policy called on agencies to make every effort to give priority to making timely payments to minority owned and small businesses.

The Treasury and the Office of Management and Budget as well as OMB's Office of Federal Procurement Policy, have called on agencies to include specific payment terms in contracts and purchase orders as recommended in our 1978 report. Nevertheless, for the most part, specific payment terms are not included because procurement regulations for both the the military and civil agencies do not call for them.

The Federal Acquisition Regulations, now being developed by the Office of Federal Procurement Policy, are to include the standard 30 day payment practice as currently specified by Treasury. The Office of Federal Procurement Policy currently estimates that implementation of the Federal Acquisition Regulations, which will replace the military and civil procurement regulations, can begin in December of this year. By standardizing the Federal procurement procedures, including the forms to be used, and by requiring an agency contact point for all payment matters, the Federal Acquisition Regulations should further strengthen Federal payment performance.

NEED FOR CURRENT MONITORING OF BILL PAYMENT PERFORMANCE

The above actions should help improve the timely payment of bills. However, current Government-wide bill payment statistics, which could be used to evaluate agency implementation of these requirements, are not readily available. As I mentioned previously, Treasury regulations provide for monitoring of cash management practices. Agencies were to report to the Treasury at least annually, beginning in 1979, on cash management practices including information on late payment of bills. However, 2 years later, Treasury had received only 18 reports although 86 agencies were subject to reporting. In addition, the reports received were of little value for monitoring the agencies' bill payment performance. The reports either did not address bill payment at all, made only broad statements such as the agency was doing a "good job," or simply promised further actions.

In limited contacts of several agencies, we were told that they were either just starting or were planning to start the required cash management practices reviews. We were also told that they were unsure as to what Treasury wanted in the way of reporting and monitoring. A Treasury official indicated that lack of staff has hampered the Department in this area. In order to insure that its regulations on bill paying are being effectively implemented, and are producing the desired results, Treasury needs to assure continual effective monitoring.

As you requested, we attempted to obtain data from selected agencies concerning payment performance. We selected five agencies with more than $1 billion of annual disbursements each. Generally, sufficient information was not readily available. However, according to the Department of Agriculture which had some statistics available, during 1980, the Department paid 92 percent of its bills and 87 percent of the dollar total within 4 weeks after receipt of the invoices. Based on 4th quarter fiscal 1980 statistics, the General Services Administration showed that all of its payment centers paid 90 percent or more of their invoices by the due date and that most centers paid significantly above 90 percent. Also, the agencies we contacted indicated that paying bills early was still a problem. For example, Agriculture reported that during 1980 it paid 76 percent of its invoices within 2 weeks and an additional 12 percent during the third week.

ANALYSIS OF THE PROPOSED LEGISLATION

The proposed legislation, in requiring Federal agencies to pay interest on overdue payments and to take early payment discounts only when payment is timely, would protect contractors who, through no fault of their own, experience long delays in receiving payment. Further, the bill would provide for congressional oversight by requiring Federal agencies to file an annual report.

Interest on Delinquent Payments

Our 1978 report recognized the concept of the Government paying interest on late payments both to compensate contractors for losses incurred and to motivate agencies to pay bills on time. Legislation to provide for the payment of interest by the Government on overdue bills was introduced during previous Congresses. The Office of Federal Procurement Policy previously opposed such legislation. It took the position that legislation was not needed because it already has authority to require an interest clause in contracts and purchase orders. Our Office, in a 1971 decision

(51 Comp. Gen. 251), held that agencies could issue regulations authorizing the inclusion of interest payment terms in contracts and purchase orders for late payments. The Office of Federal Procurement Policy, however, has not done so because of the difficulties it foresaw in implementing such a charge and the administrative burden it would impose.

We share the concern of the Office of Federal Procurement Policy that interest on late payments could result in an administrative burden. Agencies would have to develop systems for tracking all invoices and documenting actions to determine who caused the late payment--the contractor or the Government. This could require extensive redesign of existing payment systems--both manual and automated. The systems would also have to be redesigned to provide for the verification and computation of interest charges. Undoubtedly, additional personnel would be required to administer interest charges. Further, the arbitration of disputes could be costly for both sides. Most importantly, charging interest could ultimately delay the payment of invoices.

Complicating this entire process is that often more than one agency is involved in making a payment. For example, the Defense Contract Audit Agency audits invoices on many contracts before payment is made. Contractors mail these invoices directly to the Defense Contract Audit Agency, which after completing its work, sends each invoice to the contracting agency for payment. Unless it is a Defense activity, the agency involved, after processing the bill, sends it to the Treasury for payment.

Since we previously found that for the most part, the Government's bill payment performance is good, we believe that the best solution--for the Government and the contractors--would be to speed up the bill paying process. Relatively few contractors would then be paid late and an interest charge may not be needed. However, as our 1978 report makes clear, it is not equitable for contractors to suffer because of long payment delays caused by Federal agencies. If some contractors, through no fault of their own, experience long delays in receiving payment, the merits of imposing an interest charge should be considered along with other alternatives.

As I discussed earlier, one of the major problems identified during our review was the lack of consistent Federal policy defining when payment is due. Treasury has since established a payment policy which is in general agreement with the proposed legislation. We see no compelling reason why most invoices cannot be paid within 30 days of receipt, provided that contractors perform according to the contract terms and provide a correct invoice promptly to the right payment center. However, one rule may not fit all situations. Because of the wide variety of goods and services purchased, some deviations may be necessary--for instance in the cases of advance payments, recurring payments that have a fixed due date, and payments for goods and services which must be tested prior to acceptance to protect the Government's interest. Therefore, whenever possible, specific payment terms should be included in purchase orders and contracts.

Although we are most sympathetic to concerns of contractors who have not received timely payments, the problem of early payment also must be addressed. Contractors have benefited from early payments which we found, in dollar terms, to be a greater problem than late payments. The findings on early payments in our 1978 report were confirmed in an August 1980 report "Strengthening Cash Management in the Federal Government" prepared by the Office of Management and Budget. The practice of paying bills before they are due projects a favorable image of the Government as a bill payer, but is contrary to sound cash management principles. In formulating Federal payment policies the cost of borrowing must be considered along with promoting good contractor relations and the advantage of taking discounts.

I would like to take this opportunity to provide to the Subcommittee our specific comments on the provisions of the bill relating to the interest period and interest rate.

Interest Period

The proposed legislation is in general agreement with current Federal policy established by Treasury in calling for payment to be made within 30 days after receipt of a proper invoice in cases where the contract does not specify a payment due date. We support this approach.

We have some concern, however, as to the provision in the legislation concerning those cases where a payment due date is specified in the contract. Treasury regulations presently require these payments to be made when due as specified. The proposed legislation, however, calls for an interest charge on these payments if not made within 30 days from the due date. This provision could delay these payments by 30 days without interest. We recommend that the Subcommittee address this when considering the bill.

Also, although defining what is meant by a "proper invoice," the bill does not expressly state that payment of an invoice is not due unless the goods or services are received by the Federal Government as required. In cases where the invoice is received prior to the goods or services, Treasury regulations now provide that payment will be made no later than 15 days from the receipt of goods and services, but not prior to the due date.

Further, the bill does not define at what point payment is considered made. For instance, is payment made when received by the contractor, when mailed by the Government, or when the payment check is dated? In addition, although completely agreeing with the principle that payments should be made when due, as a matter of Federal policy, it may not be appropriate to consider, as late, payments made 1 day after the due date or to consider, as early, payments made 1 day before the due date. The Subcommittee should consider, with input from Treasury and the Office of Management and Budget, whether a few days leeway should be allowed in paying bills, taking into account the need to preclude undue payment delays while at the same time keeping Federal borrowing and resultant interest costs at a minimum.

Interest Rate

The bill calls for Treasury to determine the interest rate taking into consideration current private commercial rates of interest for new loans maturing in approximately 5 years. With respect to interest charges by the Federal Government on delinquent debts owed to it, we have called for rates commensurate with the current value of funds to the Treasury, which the Administration supports. The Subcommittee may wish to consider in this legislation the use of the same interest rate charged by the Government in assessing interest on delinquent amounts owed to it.

I will now address discount payments and congressional oversight.

Discount Payments

We support the legislation in calling for the Federal Government to take early discounts only when payment is made within the specified time for earning the discount. It is patently unfair to do otherwise. In a November 1980 letter, the Office of Federal Procurement Policy stressed to heads of Federal agencies to "take discounts only when merited and not after the discount period has expired."

Congressional Oversight

We also strongly support congressional oversight of Federal Government bill payment performance through annual reports from Federal agencies on late payments. We believe that oversight is one of the keys to ultimately improving Federal Government bill paying.

As I discussed earlier, figures on the Government's current bill paying performance are not readily available. Treasury should, as part of its monitoring system, require agencies to report:

--Actions completed, underway, or planned to strengthen bill payment procedures.

--The number and dollar total of (1) bills paid on time, (2) bills paid late, and (3) bills paid early.

--An aging of late and early payments.

If Treasury takes the lead in strengthening the monitoring system it set up in 1978, Congressional oversight reports could be prepared in conjunction with this system. The Subcommittee may wish to add a provision to the legislation requiring agencies to report the above information to Treasury annually and to have Treasury submit a summary report to Congress.

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In summary, although we previously found that the Government's bill paying performance was more often good than bad, lengthy delays did occur and many contractors believed they were not paid fast enough--16 percent of those responding to our questionnaire were dissatisfied. Certain actions, to improve bill paying performance have been taken since our prior report, such as the establishment of a standard for when a payment is due.

However, the impact of these changes has not been measured. Treasury needs to take the lead, together with the Office of Management and Budget, in monitoring payment performance Government-wide. We recommend that agencies be required to provide comprehensive reports to Treasury and the Office of Management and Budget on bill payment performance, and that the results of evaluations of the reports be provided to the Subcommittee in time for use in considering the legislation it now has before it to pay interest on late payments. The Subcommitte should be advised of any problems and be furnished a timetable showing when appropriate corrective actions will be taken.

As addressed earlier, if the recommendations in our 1978 report for speeding up payments are properly carried out, relatively few contractors would be paid late. Thus, an interest charge might not be necessary. However, if improvements are not effectively carried out and long delays in payments continue, the merits of imposing interest should be considered.

This concludes my statement. We will be happy to respond to any questions you or other Members of the Subcommittee may have.