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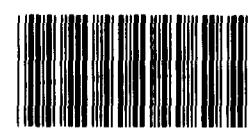
Testimony

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**Federal Agencies' Bill Payment Performance
and Comments on Proposals to Amend the
Prompt Payment Act**

Statement of
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Before the
Subcommittee on Legislation and National
Security
Committee on Government Operations
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to talk about the results presented in our August 1986 report on bill payment progress and to offer our views on proposed amendments to the Prompt Payment Act passed in 1982.

The Prompt Payment Act has provided a strong foundation for making the government a more responsible billpayer. We have long supported the concepts in this act, and we worked closely with this Subcommittee in 1982 when it developed this legislation under your leadership. We support this Subcommittee's efforts to strengthen this important legislation, and we generally agree with the proposed amendments in S. 328, which was passed by the Senate in October 1987, and H.R. 1663, which was introduced in the House in March 1987.

Although we have seen progress since our initial governmentwide payment-timing performance assessment in 1978, there is still a lot of room for improvement. The proposal to amend the act underscores the Congress' insistence that agencies make a full-fledged effort to pay their bills on time. So, while the Prompt Payment Act has essentially worked well, 5 years' experience shows that it still needs to be fine tuned. We fully support the concepts in the proposed amendments, such as:

- "assuming" acceptance of goods or services 5 days after delivery for purposes of determining the payment due date and computing late payment interest penalties,
- shortening the grace period,
- emphasizing that agencies voluntarily pay late payment penalties,
- defining the start of a discount period,
- expanding agencies' reporting requirements, and
- including prompt payment provisions in the Federal Acquisition Regulation.

However, we do offer a few suggested changes to the current language of the proposed amendments.

PROBLEMS IN PAYING BILLS ON TIME CONTINUE

Before discussing these changes, I would like to briefly highlight the findings from our August 1986 report on governmentwide bill payment-timing practices and actions the

administration has since taken in response to that report's recommendations.

About 2 years ago and at your request, we evaluated the government's payment-timing performance since passage of the Prompt Payment Act. We testified before this Subcommittee in July 1986,¹ and in August of that year issued a report² on the results of that evaluation.

Our work clearly showed that since our 1978 evaluation, agencies had achieved some of the improvements sought by the act and the related Office of Management and Budget (OMB) regulations and Department of the Treasury initiatives. Compared with the results presented in our 1978 report,³ our 1986 report showed that agencies had noticeably reduced the percentage of early and excessively late payments. In fact, reductions in early payments saved the government millions of dollars in annual interest costs. At the same time, fewer excessively late payments no doubt helped to ease some companies' cash flow problems.

¹"Federal Agencies' Bill Paying Performance," Statement of Frederick D. Wolf, Director, Accounting and Financial Management Division, before the Legislation and National Security Subcommittee, House Committee on Government Operations, delivered on July 29, 1986.

²Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits (GAO/AFMD-86-69, August 28, 1986).

³The Federal Government's Bill Payment Performance Is Good But Should Be Better (FGMSD-78-16, February 24, 1978).

Nevertheless, agencies' performance was still far short of that envisioned by the 1982 act. We reported in 1986 that about one-fourth of the commercial payments were still late, and agencies often did not pay required interest penalties. Another fourth of the bills were paid early, and we estimate that such early payments cost the government at least \$120 million in lost interest income during our 4-month test period. Thus, considering the requirement to pay by due dates and prudent cash management principles which counsel against paying too early, agencies paid only about half of their commercial bills within the period considered as "on time."

We understand that a recent review by the inspectors general through the President's Council on Integrity and Efficiency has found that, at the activities reviewed, performance is still pretty much as we reported it to be in 1986. Also, in a February 1988 report⁴ to the Subcommittee on Readiness, House Committee on Armed Services, we state that the Navy exchanges and the joint Army/Air Force exchanges were also experiencing difficulties in paying their bills when due. We found that about 24 percent of our sample of invoice payments were paid late, and another 11 percent were paid too early. Also, appropriate interest penalties generally had not been paid, and in some cases, discounts were taken after allowable periods expired and had not been refunded.

⁴Prompt Payment Act: Military Exchanges Had Problems in Paying on Time (GAO/AFMD-88-17, February 9, 1988).

We made a number of recommendations in our August 1986 report. OMB and the agencies responsible for the Federal Acquisition Regulation (FAR)--the Department of Defense, the General Services Administration (GSA), and the National Aeronautics and Space Administration--have since taken some corrective actions. OMB issued revised prompt payment regulations in June 1987, and prompt payment provisions were added to the FAR in February 1988.

There are many different players involved in the payment process. A simple omission by one of them, such as not indicating on a receiving report dates when the goods or services are received and when they are accepted, can prevent timely payment no matter how diligent others are or how automated the payment system is. Thus, it is important to specify responsibilities in detail.

The specificity of the language in the FAR provisions should help considerably to ensure that the many government components involved in the payment process know what they have to do to make sure a bill gets paid when it is due. This was not always the case in the past. For example, receiving reports often did not indicate the date the government received the goods or services or the date they were accepted. The FAR provisions now specifically require that such dates be recorded and also spell out that these dates must also be noted on an invoice when it is used as a

receiving report. OMB also somewhat improved guidance on information required for calculating payment due dates in its revised prompt payment regulations issued in June 1987.

THE NEED FOR AMENDMENTS TO THE PROMPT PAYMENT ACT

While agencies' adherence to the revised OMB and new FAR guidelines should help improve the government's payment timing, this does not diminish the value of legislation such as you are considering. Mandating certain matters by law will underscore the urgency to accelerate the management and administrative initiatives required to achieve the government's prompt payment objectives while also helping to ensure continuity and permanence.

Last March, we testified in support of S. 328 before the Senate Committee on Governmental Affairs.⁵ I will now highlight a few of our suggestions and observations regarding the provisions in the proposed amendments to the Prompt Payment Act.

Starting Point for Payment Periods

Both the Prompt Payment Act and section 3 of the proposed amendments state that if a contract does not contain payment-

⁵"Federal Agencies' Bill Paying Performance and Comments on S. 328, a Bill to Amend the Prompt Payment Act," Statement of Jeffrey C. Steinhoff, Associate Director, Accounting and Financial Management Division, before the Senate Committee on Governmental Affairs, delivered on March 19, 1987 (GAO/T-AFMD-87-3).

timing terms, the beginning of a payment period is the latter of two events: (1) receipt of an invoice or (2) acceptance of goods or services as satisfactory. The amendments would establish a "conclusive presumption" that, unless the applicable contract states otherwise, acceptance will legally be deemed to occur on the fifth day after the goods are delivered or services are completed. Thus, under certain circumstances, the bill would require using presumed rather than actual acceptance dates for calculating the beginning of a payment period.

Our understanding is that this proposed change is intended to avoid situations in which vendors have satisfactorily carried out their obligations but agencies unreasonably extend payment due dates by not accepting goods or services in a timely fashion. We agree with the apparent intent of these provisions and note that it is now included in the FAR and addressed in OMB's revised Circular A-125 as well. We have some concern, however, that using a "conclusive presumption" of acceptance as presented in the proposed amendments could be interpreted as preventing agencies from rejecting unsatisfactory merchandise or services if they do not do so within 5 days (or another contractually specified period) after delivery.

We think that an amendment along these lines should clearly state that 5 days generally would be the period only for the purpose of computing the payment due date and calculating late

payment interest penalties owed. If an agency then takes 10 days to accept, it would have 5 days fewer to pay the bill. For example, the 30 days agencies generally have to process a bill for payment would shrink to 25 days in that case. The provisions in the FAR are very clear on this point, and we suggest that similar language be used in amendments to the act. We are providing suggested language on this issue in our detailed comments on S. 328.

Eliminating Grace Periods

Section 4(a)(1) of the proposed legislation would eventually eliminate grace periods--periods during which agencies may pay bills late without incurring interest penalties. While we understand vendors' concern about grace periods and recognize that OMB has previously endorsed complete elimination of such periods, we see merit in keeping some such periods but shortening the present 15-day period to 7 days. We have some concern that completely eliminating grace periods over the short term could increase the government's administrative costs for paying commercial bills and result in further delays for some payments.

This applies especially to civil agencies which do not issue their own checks but, instead, send schedules of approved payments to the Treasury for check issuance on a specific day. Delivery time to the Treasury--mostly by mail--can fluctuate considerably,

and Treasury processing time can take somewhat longer than anticipated. Agencies cannot fully compensate for these factors because payment centers (1) attempt to send to the Treasury only one schedule of payments due on a particular day and (2) generally do not finalize and forward such schedules until about 5 days before the due date.

There are valid reasons for the payment centers' actions. In the interest of efficiency, the Treasury wants payment schedules recorded on magnetic tape to include at least 100 payments. Also, Treasury issues all checks for payments listed on a schedule on the same day. Consequently, hundreds of low-volume payment centers generally must consolidate all or most of their invoices due on the same date on one schedule if they want to use an automated payment process. However, documentation needed to ensure that the payments are proper (such as invoices and receiving reports) frequently does not arrive at a payment center until just before the due date. Thus, forwarding schedules earlier than 5 days before the due date would almost certainly require that all, or additional, schedules be prepared manually. This would be less efficient and increase the risk of making duplicate payments because manually processed payments bypass certain critical automated systems checks and edits. At your request, Mr. Chairman, we did a review about 3

years ago on whether agencies made duplicate payments and found that manually processing bills did indeed increase the risk of making duplicate payments.⁶

Also, eliminating grace periods could actually further delay some payments. The Treasury may only issue checks in amounts authorized by an agency. Therefore, if mailing time was unusually long and checks could not be issued by the due date indicated on a payment schedule, Treasury would have to return the particular schedule to the respective agency to obtain approval to pay late payment penalties. Returning these schedules would become particularly important if the double interest penalty provision included in this bill became law. However, returning the schedule would delay these payments even further and add additional administrative costs for both Treasury and the agencies.

Finally, eliminating grace periods may encourage agencies to make payments before they are due in order to avoid incurring interest penalties. Although this would benefit vendors, we estimated in August 1986 that federal interest costs attributable to early payments far exceeded the amount of penalties owed to vendors for late payments.

⁶General Services Administration Needs To Improve Its Internal Controls To Prevent Duplicate Payments (GAO/AFMD-85-70, August 20, 1985).

While in our August 1986 report we estimated that agencies made about 15 percent of commercial payments during grace periods, we did not find intentional abuses such as routinely paying as closely as possible to the end of such periods. Instead, almost 60 percent of grace-period payments were made within 5 days after they were due.

When the Prompt Payment Act was passed in 1982, short delays in payments were not the issue. Instead, contractors and their representatives pointed out that payments which were delayed for 3 or 4 months or even longer were the problem. Thus, an alternative might be to shorten the current 15-day grace period to perhaps 7 days. This alternative would be more equitable to vendors than the current 15-day grace period and should not disrupt agency payment operations. This alternative would also be in keeping with the original intent of the Prompt Payment Act of reducing excessively late payments rather than those that may be late by only a few days.

As stated before, we are aware from testimony last year in the Senate that OMB endorses the elimination of the grace period. We understand that OMB based its endorsement, at least in part, on agencies' reports which showed that most of their 1986 grace period payments had been made in the first 7 days of the grace period.

Late Payment Penalties

Section 4(b) of both bills would require agencies to pay double interest penalties if they do not automatically pay any penalties due and if a vendor subsequently writes to ask that such penalties be paid. We agree that agencies should pay penalties they owe and doubling penalties would be a strong incentive to do so. However, we are not aware of any similar practices in the private sector.

We noted that agencies often did not pay required interest penalties. This was more often the result of poor management and administrative controls rather than of any purposeful withholding of penalty payments.

Paying closer attention to the many details required, such as recording pertinent dates on receiving reports and invoices, and implementing other improvements as recommended in our report, would increase the percentage of on-time payments as well as help ensure that any required penalties are paid. In addition, we believe that the requirement for more detailed reporting of agencies' payment-timing performance--and validation of the information by agency inspectors general--will also be a strong incentive for agencies to pay penalties when due.

Finally, we continue to believe that, although some of the millions of bills agencies pay annually will always be paid either too late or too early, modernizing agencies' accounting systems, which include payment systems, and thus eliminating the need to move the great volume of paper from one place to another, should significantly improve agencies payment-timing performance. In our view, this would also be the appropriate time for eliminating the grace period.

Discount Periods

Two sections of the proposed legislation seem to offer conflicting guidance regarding the start of discount periods. Section 8 appears to provide uniform criteria by defining the beginning of discount periods as the date an agency receives an invoice. However, section 10(b)(4) states that agencies may take discounts only in accordance with vendor terms.

Adding due-date criteria for discounts would result in more uniform contract terms. Uniformity, whenever possible, is desirable because we found that varying payment terms were one of the primary causes for improperly taken discounts. However, we believe that the terms as defined in the bill should apply only if the pertinent contract and invoice are silent on the matter. This

offers the government and the contractors the opportunity to set appropriate terms in each contract and gives a contractor another chance to offer a discount when requesting payment.

Reporting Payment-Timing Performance

Section 9 of the proposed amendments expands agency reporting requirements for late payments and addresses two factors which contributed to OMB's overstating agencies' payment-timing performance in the past.

Some agencies based their reported performance data on the number of invoices for which they had paid interest penalties. Others reported based on the number of payments, that is, the number of checks issued--checks which often cover numerous invoices. We also noted that some contracts for utilities called for prescribed late payment penalties rather than interest when bills are paid late. Some agencies did not report such penalties because the law and OMB's regulations call only for reporting interest penalties.

We prefer the language contained in S. 328 because it clearly states that the reporting is to be based on invoices paid and that all late payment penalties must be included in the reports. Language in H.R. 1663 and OMB's revised regulations is less precise. H.R. 1663 calls for reporting based on payments and

interest penalties, rather than on invoices for which interest and other late payment penalties were paid. OMB's revised regulations call for reports based on invoice payments, which some agencies consider as checks issued, and also limit reporting to interest penalties only. This may continue to contribute to reports which understate the extent of the late payments agencies make.

Implementation Through the
Federal Acquisition Regulation

Section 10 of the proposed legislation would require including solicitation and contract clauses regarding due dates in the FAR for use by contracting officers. The FAR was revised in February 1988 to include prompt payment provisions and now contains this due-date clause requirement. As stated in our August 1986 report, a primary cause of late payments was the lack of standard payment-timing clauses in contracts. We are convinced that widespread use of standard clauses for establishing due dates will substantially improve agencies' payment-timing performance and also reduce their administrative costs.

On a related matter, section 10(b)(1)(C) of the bills requires that progress payments or, more precisely, payments for accepted, completed phases or segments under construction projects be made within 7 days unless prevailing industry practice allows more time. Project diversity, the billions of dollars involved,

and the fact that many agencies need up to a week just to process payments, create some concerns about establishing such a short payment period. Also, purely from an economic standpoint, even small shifts in payment timing can change federal interest costs by millions annually. It is important that the government receive appropriate compensation--such as adequate consideration in setting prices--for earlier payments. Otherwise, overall federal costs will increase.

Reducing Bill Payment Work Load

A matter not requiring legislation but with potential for savings is reducing the number of bills the government must handle. Statistics we gathered during our 1986 review indicate that about 26 percent of commercial bills agencies receive may be for \$100 or less. Considering that agencies annually pay about 30 million invoices, there could be about 7 million bills with invoice amounts of \$100 or less.

To demonstrate this point, one of the GSA transactions we reviewed involved a payment for \$998.25. This payment was supported by 64 bills from the same company, due on the same day, with individual invoice amounts ranging from \$1.75 to \$90.00. Seventeen of these were for \$1.75 each. Regardless of the invoice amount, processing a bill for payment is very labor intensive, generally requiring handling by several individuals. Therefore, we

wrote to the Deputy Director of OMB on January 12, 1987, and suggested that it may be appropriate to explore ways to cut down on the volume of bills that have to be paid.

One technique for reducing the number of invoices an agency must handle is to arrange for summary billing with the vendor when contracting for goods or services which otherwise would result in numerous small bills. Such arrangements could specify monthly or other summary billing intervals. This practice would also reduce vendors' invoice preparation and mailing costs. With fewer invoices to handle, agency payment centers could eliminate some of their bill processing backlogs, and payment clerks could better ensure that payments are made in accordance with contractual payment due-date terms.

OMB has acted on our suggestion in this area and now requires that, where appropriate, contracts spell out that multiple invoices for multiple deliveries during the same contract performance period be paid with one payment. It is important that agencies use this as a means for reducing the great number of bills having very small dollar amounts.

In conclusion, Mr. Chairman, while offering some technical suggestions, we do support the thrust of the proposed amendments to the Prompt Payment Act. We have provided more detailed comments on the amendments to you and would like to have them

included for the record. We are prepared to continue working with the Congress on this matter and would be pleased to respond to any questions you and the other Subcommittee members may have at this time.