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STATEMENT OF
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BEFORE THE
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE,
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

ON

FEDERAL AGENCIES' BILL PAYING PERFORMANCE

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our assessment of whether federal agencies pay the private sector on time for more than $200 billion of goods and services the government purchases each year. The timeliness of agencies' bill paying is an important issue because it affects both the private sector as well as the federal government. On the one hand, delayed payments hurt companies' cash flows and, depending on business volume, can require borrowing that otherwise might not be necessary. Conversely, if agencies pay well in advance of required due dates, they increase federal interest costs.

In 1978 we reported[1] that agencies were often paying their bills either too early or too late. One of the major causes was the absence of any governmentwide criteria establishing when

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

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payment ought to be made. As a principal sponsor in its passage, Mr. Chairman, you are aware that the Prompt Payment Act of 1982 provides definitive due date criteria and, as an incentive to reducing late payments, requires that agencies include penalties with any excessively late payments. The Office of Management and Budget (OMB), in its implementing regulations, and the Department of the Treasury have also stressed that agencies should not pay commercial invoices until shortly before the due date in order to reduce the government's interest costs.

At your request, we have evaluated the government's payment timing performance since passage of the act. This review included visits to 39 bill paying offices where we reviewed 1,520 statistically selected invoices that agencies paid between May and August 1985. These are representative of domestic payments made by 20 federal departments and agencies which pay about 95 percent of the government's bills for goods and services provided by the private sector. We also held discussions with many people inside and outside the government who are involved in federal bill paying activities.

SUMMARY RESULTS

The bottom line results of our review indicate that passage of the Prompt Payment Act--made possible by your Subcommittee's assistance--and its implementation by OMB combined with Treasury initiatives, have substantially improved the government's bill paying performance. There has been some reduction in the excessively late payments to suppliers and simultaneously the government saved hundreds of millions in interest. Unfortunately, however, the full potential of this legislation has not yet been realized, and a significant number of vendor invoices are still being paid later than they should be.

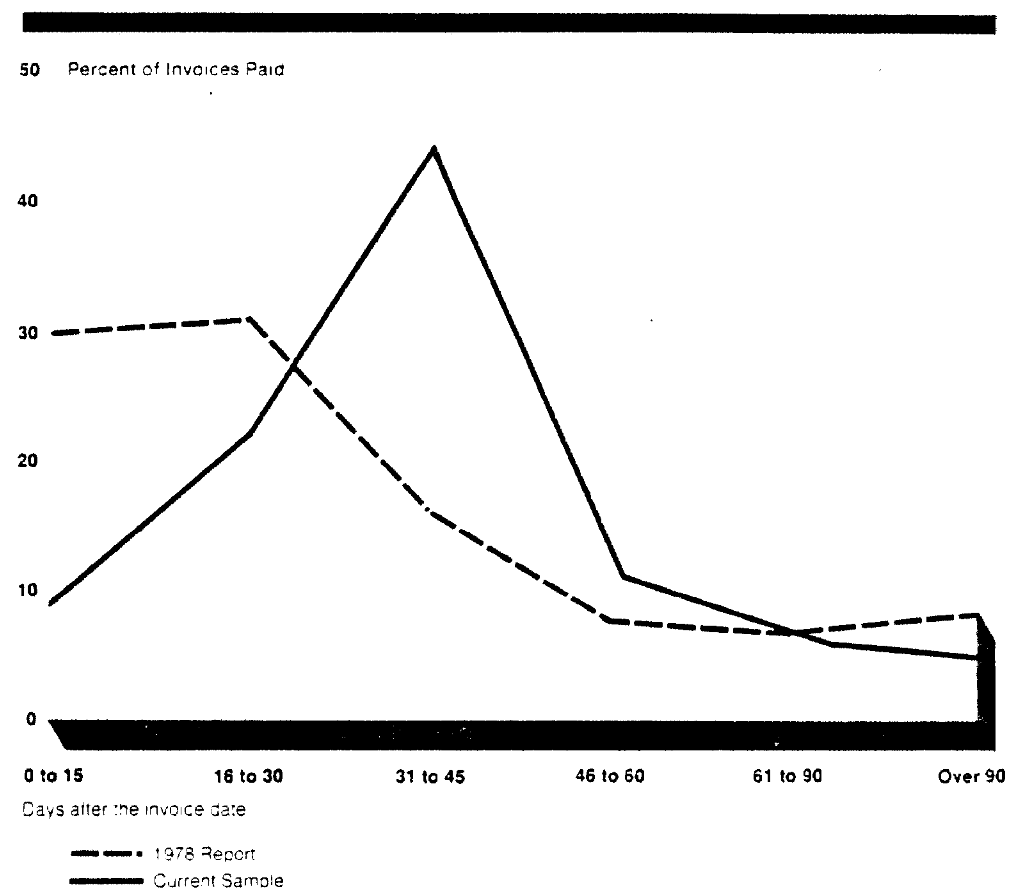
In particular, we continue to fall short of the act's goals because the number of excessively late payments remain too high. Also, of great concern is the fact that when vendors are paid too late, they do not routinely receive the interest penalties owed to them. Furthermore, OMB's reports to the Congress on performance under the act have been misleading and, thus, mask the need for corrective action. Your hearings and our review have recently prompted some actions by OMB and others to focus on the payment timing issue. If federal agencies follow through on these initiatives to address the remaining problems, they will be able to move toward achieving the full potential of the act.

The remainder of this testimony will focus on the detailed results of our review, the causes of the problems we identified, and the specific actions needed to resolve these problems.

OVERALL PAYMENT PERFORMANCE

As I said, our analysis indicates that payment timing, both early and late, has improved since we last reported on the government's performance in 1978. As a whole, federal agencies are trying to comply with prompt payment provisions. However, further efforts are required to increase the number of on-time payments. The following figure illustrates the effect that the act and the related OMB guidelines and Treasury initiatives have had in making the majority of the government's commercial payments closer to the due date.

Comparison of Current Payment Timeliness With Statistics in Our 1978 Report



The private sector has benefited from reductions in both the number of late payments and the number of days by which individual payments missed due dates. On the other hand, fewer payments made well before the due date allowed the government to save money by not paying out its available funds as early.

However, we estimate that governmentwide, including discounts taken after the discount period, agencies still paid almost a quarter of their commercial bills after the due date. Furthermore, close to 5 percent of the payments should have included penalties. Some of these payments were extremely late. We found that 8 percent of our sample payments were made between 45 and 150 days after the due date, with 2 percent being over 90 days late. These, more than likely, represent the problem cases that generate vendor complaints and perpetuate impressions that agencies pay too slowly.

Compounding the problem of paying late is the fact that agencies frequently did not pay the penalties they owed and did not repay improperly taken discounts. We identified 66 invoice payments in our sample which should have included late payment penalties. However, agencies had paid penalties for only 10 of these. In other words, five out of every six vendors entitled to interest penalties did not receive them. We also found that of the 239 discounts taken in our sample, agencies took 44, or over 18 percent, after the discount period had expired. Agency officials told us that none of the improperly taken discounts had been repaid to the vendors.

On a more positive note, our work did not affirm the frequently heard assertions that payment centers as a rule purposely delay payments until shortly before the end of grace periods (normally the 15 days after the due date) during which, for administrative ease, interest does not have to be paid.

Rather, almost 60 percent of our sample payments made during a grace period occurred within 5 days of the due date. However, it is important to note that about 20 percent of all the invoices in our sample were paid during a grace period.

Looking at the payment issue from the government's perspective, it is also important that agencies not pay too far in advance of the due date because early payments increase the government's interest costs. We estimate that close to a quarter of all payments agencies made during our 4-month test period occurred 5 or more days before they were due. We estimate that such early payments cost the government approximately $200 million in interest during this same 4-month period. About 40 percent of this amount was attributable to the Department of Defense's (DOD's) early payment policy on contract financing transactions, such as progress payments on long term projects. This would suggest that the government's annual added interest cost from early payments would be in the $500 million range. If, as noted later, DOD receives vendor concessions in exchange for such early payments, the loss figure would be lower.

CAUSES OF LATE AND EARLY PAYMENTS

A variety of factors, including weak internal controls at agency activities directly involved in the payment process, caused many of the late and early payments. Other reasons included widely varying and ambiguous payment terms in contracts and agency policies and procedures which differed from prompt payment provisions.

Under the act, agencies are to pay in accordance with terms specified in the contract. If no contractual terms have been established, payment is due within 30 days after the agency receives a proper invoice or actually accepts the goods or services as satisfactory, whichever is later. Contractual terms may use the same or other dates, such as when the goods were delivered, as a basis for determining when payment is due. Accordingly, payment center staff must have copies of the relevant contracts and be provided the dates when certain events occur to determine when a bill should be paid.

Our review showed that missing information is a major barrier to effective implementation of the Prompt Payment Act. Three years after its passage, agencies still did not have adequate controls in place to ensure that needed date information and contracts were routinely available at payment centers in order to establish accurate due dates. To illustrate the extent of the problem, essential data was not available to center staff to calculate correct due dates for almost a third of the invoices in our sample.

Although missing contracts and dates were more severe at some centers, it was a rather widespread problem. We found that 28 of the 39 payment centers we visited did not have all of the contracts pertaining to our sample invoices. Fourteen centers did not have contracts for at least 20 percent, with the percent missing ranging as high as 77. In addition, 26 of the 39 centers did not have all of the dates on which our sample invoices were received or the dates when goods or services were received and accepted. This was an especially severe problem at a Department of Justice payment center where invoice receipt dates had not been recorded for 18 of the 21 invoices in our sample. We encountered similar, but less severe problems at one Department of the Interior, two Department of Housing and Urban Development, and two General Services Administration (GSA) payment centers.

To calculate correct due dates, we contacted many of the offices that were responsible for forwarding the needed date information. We also obtained over 200 contracts from agency procurement offices, other agencies, and even from the vendors involved. We pursued this information in order to calculate exact due dates. However, we do not believe that payment center staff should be expected to routinely follow up to obtain needed information for establishing due dates that other offices should be submitting in the normal course of business.

In many instances, we found that although this needed date information had been forwarded to the payment centers, it had not been sent soon enough to allow the centers to meet payment due dates. Although OMB requires activities which receive and accept goods or services to forward this date information in time to be received by payment centers within a week after acceptance of the goods or services purchased, this criteria had been met for only about 60 percent of our sample cases. Ten percent of the needed date information was received more than

4 weeks after acceptance. Cases for which receiving activities did not provide needed dates combined with those where they provided them too late, were the cause of 36 percent of the late payments we identified.

Even when the payment centers had received all the necessary date information on time, they did not consistently calculate an accurate due date. Overall, we found that payment centers were responsible for about 45 percent of the late payments in our sample. In some cases, mistakes occurred because payment centers either did not have a copy of the related contract or the staff did not check the contractual due date terms. Finding out if contracts contain payment due date terms and identifying what these terms are is important because, according to the act, contractual terms are the governing criteria and we found that such terms may vary from contract to contract. Variances were particularly apparent when agency contracting staff included predetermined acceptance periods. That is, for payment purposes, the acceptance date would be a specified number of days after the date the goods or services are delivered. The primary purpose for using other than the actual acceptance dates was to address vendor complaints that agencies were taking an inordinately long period to officially accept goods and services after they had been delivered.

The director of GSA's Office of Acquisition Policy told us that including predetermined acceptance date clauses in GSA contracts--which are used by GSA and other federal agencies for ordering merchandise--was designed to minimize any adverse effect to the vendors of slow acceptance of goods or services by agency receiving activities. She said that adhering to the predetermined terms would ensure that the payment period, such as 30 days, would begin reasonably soon after agencies received goods or services. This is because actual acceptance dates would not be a factor in determining the due date.

Predetermined acceptance periods will solve some of the problem. However, because these periods varied considerably, they also led to mistakes in calculating due dates. Some were specified as 5, 7, 10, 15, or even 30 days after a specific event, commonly the delivery date. We could not find valid reasons for some of the differences. For example, predetermined acceptance periods for purchases of paper varied from 5 to 30 days after delivery of the product. Further, we had anticipated that contracts containing lengthy acceptance terms would be for rather specialized items requiring extensive inspections prior to authorizing payment. However, one invoice for a $35 part to repair a typewriter had a predetermined acceptance period of 30 days after delivery. Another contract included the same 30-day acceptance period for a $67 quarterly bill for trash removal. In both cases, payment could have been made up to 75 days after delivery or provision of the service, and no interest would be due the vendor.

We want to emphasize that agencies should not pay a bill until they have inspected and accepted the goods or services being paid for. Therefore, such contractually defined acceptance periods will not prevent late payments which occur because agency receiving locations take too long to actually accept the goods or services, or take too long to let the payment center know that actual acceptance has occurred. Predetermined acceptance periods will, however, be more equitable to the vendors because agencies will be required to pay interest for any excessive delays.

One of the reasons for these varying terms is that the Federal Acquisition Regulation (FAR), which establishes policies that agencies are to follow in acquiring goods and services from the private sector, does not include the provisions of the 1982 prompt payment legislation. Although a stated purpose of the FAR is to provide uniformity in the acquisition process, it does not, for the most part, offer specific due date terms to be included in contracts. Instead, it instructs agencies to insert due date terms in accordance with their own policies, thus inviting variety in payment terms. During our review, we found considerable support for more uniform terms, and within the last 2 weeks, the agencies responsible for the FAR (DOD, GSA, and the National Aeronautics and Space Administration) have proposed changes to it which would help provide more consistency in agencies' use of such terms. GAO is currently reviewing the proposed changes.

We also identified different payment terms for similar products (food items) in Defense Logistics Agency (DLA) contracts, which are also used by other agencies to order merchandise. For example, a contract for frozen dairy products required payment in "10 days"; another for refrigerated or perishable pastries "11 days after arrival"; and a third for frozen juices in "30 days."

A DLA contracting official told us that the agency had previously paid little attention to due dates in vendor offers because it was under the impression that the act called for payment in 30 days regardless of contract terms. Since being informed by agency counsel that contract terms govern, he said the procurement office was attempting to include uniform terms as contracts were written or renewed.

In the current environment, where contracts often do not include payment due date terms or where such terms differ widely, use of incorrect information when calculating due dates increases the likelihood of early and late payments. For example,

--A NASA payment center paid an invoice for $171,000 a month late because the payment technician calculated the due data based on when the item was accepted. The contract provided that "Payment Terms shall be net thirty (30) days from date of invoice."

--An Air Force payment center took a 2-percent discount 18 days after the discount period had expired. The payment technician did not follow contract terms which defined the start of the discount period as the merchandise delivery date. Instead, the technician used the invoice receipt date as the start of the discount period.

In other instances, center officials misinterpreted prompt pay criteria and were using the wrong date to calculate when a bill should be paid. For example, an Army and a NASA payment center routinely used the date they received an invoice from another agency office. The appropriate date to use would have been the date the other office had originally received the invoice from the vendor. Using the later date could delay payments. In fact, we found that 40 and 48 percent of the payments we reviewed at these two centers were made after the due date. Some may have been late for this reason.

Also, some payment centers did not always schedule payments according to their established due dates. One reason for this was that to achieve savings, centers sometimes combined several invoices from the same vendor for payment with one check. However, we found instances where they neglected to consider due dates for individual invoices with the result that they paid some too late and some too early. For example, a Treasury payment center combined three invoices from one vendor, resulting in one invoice being paid late and the other two being paid 12 and 19 days early. The same center paid another vendor nine invoices on the same day; seven of the invoices were paid up to 13 days late, while the remaining two were paid 19 and 21 days early. An official at an Army payment center also told us that combining payments to issue only one check may have caused some of the center's late payments. Although such savings initiatives are prudent, they must be exercised carefully to avoid losing the intended benefits of establishing precise due dates.

Reasons Interest Not Paid

I mentioned earlier that agencies did not pay all required interest penalties. We identified unpaid penalties at 24 of the 39 centers we reviewed. In many cases, this was because they did not calculate the correct due date or schedule the payment according to an established due date. Although these appeared to be simple mistakes, we did find that 3 of the 39 payment centers we visited had local policies not to pay interest unless the vendors asked for it. At one Army location, we calculated $239 of interest penalties owed but not paid on six late payments in our sample. Two of the penalties exceeded $90 each. Payment technicians at this location told us that they had not paid interest because the center's policy was not to pay penalties unless vendors complained. However, the official in charge did not acknowledge such a policy even though the center had not reported paying any late penalties during fiscal year 1985. At the two other locations, officials acknowledged having local policies not to pay interest unless a vendor asked for it.

Also, Air Force regulations administratively extend grace periods for certain commodities--meat and perishable agricultural products--if the vendors do not provide an invoice in time to pay by the due date. Having an invoice prior to payment is a good internal control feature for ensuring accuracy of disbursements. However, according to the act, payment due dates and corresponding interest penalties are to be based solely on the date these items are delivered. We found that adherence to these Air Force regulations resulted in seven interest penalties not being paid at five Air Force locations.

Other Problem Areas

Another DOD policy, affecting payment of billions of dollars annually, also differs from prompt payment requirements. Under this policy, progress and other interim payments--partial payments made before goods or services are delivered and accepted--are to occur within 5 to 10 days after receiving a payment request even though these due date terms are not stated in the contracts. This is inconsistent with OMB prompt payment criteria which calls for payment close to but not later than the 30th day unless other terms are specified in the contract. By making these payments earlier than required by OMB, DOD increases the government's interest costs. However, DOD, in a recent study report, says its pricing and profit policies include consideration for payment timing and, consequently, early payments of this type do not actually increase overall government costs. We are currently reviewing the DOD report's conclusions and recommendations in a separate evaluation.

On a related cash management issue, OMB requires any payment made 3 or more days before its due date to be reported to it. About a third of the centers we reviewed rely on Treasury to issue the checks and must also allow for mailing time when scheduling invoices for payment. Attempts to consistently meet OMB's 3-day criteria could cause more payments during grace periods. This is because these centers could be expected to allow only a minimum time for mailing and check issuance in order to preclude the possibility of early payments.

Previous Audits Disclose Problems

Mr. Chairman, federal managers should have been aware of most of the problems and contributing causes we identified. Agency management and internal audit reports have identified extensive problems with early and late payments, including not paying required penalties. They also have questioned the accuracy of agency reports to OMB concerning payment timing performance. Accordingly, agencies had sufficient bases for taking some corrective action.

Reporting Problems Identified

On the topic of OMB's reporting, since 1983, its annual reports to the Congress on payment timing performance have stated that the government pays 99 percent of its bills on time. This is not an accurate assessment of agencies' performance. The act requires OMB to report any interest penalties that agencies have paid. However, in presenting this information, OMB in essence concluded that any payments which did not have interest penalties included were paid on time regardless of whether interest was due or whether payments occurred by the due date. As I said before, we estimate that agencies paid only about 75 percent of their commercial invoices by the due date and that almost 5 percent should have included late payment penalties.

The difference between the 99 percent on-time performance reported by OMB and our estimate that 75 percent were paid by the due date can be largely explained by the categories of late payments which OMB did not count as late. These are

--payments made during grace periods,

--payments made after a grace period but which did not require a penalty because the amount did not equal at least $1, and

--late penalties owed but not paid.

ACTIONS REQUIRED

Mr. Chairman, closer adherence to prompt payment objectives would enhance the government's reputation in the business community as a bill payer. Any substantial strides toward this end will require making progress in four broad areas.

1. <u>Getting required information</u>

Agencies must improve their internal controls to make sure that activities which receive and accept goods or services and related invoices consistently record the dates that such events occur and provide this information to payment centers immediately. These are simple tasks to perform, and payment centers cannot be expected to routinely devote scarce staff resources to follow-up calls to obtain required dates or to remind other agency offices to submit them in a timely fashion. Similarly, payment center officials must make sure that they receive and properly file copies of contracts for which the center makes payments.

2. <u>Using information to pay on time</u>

Efforts to compile and make the appropriate data available to payment centers is wasted unless center staff use it to calculate precise due dates and schedule disbursements in accordance with such due dates. Accomplishing this will require adequate training to maintain staff familiarity with prompt payment provisions. Also, until payment due date provisions become more uniform, payment center officials must make certain that their staff is aware that contractual payment due date terms often vary, and that they consider all such terms when determining when a bill must be paid.

3. <u>Conform agency policies to existing guidelines</u>

Federal activities not directly involved in the payment process also contributed to late and early payments. Many payment timing errors could be prevented by developing simple payment terms, including them in the Federal Acquisition Regulation, and requiring that, unless deviation is justified, these terms be used on an across-the-board basis.

Agency officials also need to examine whether agency or local center policies conflict with the basic requirements and goals of the act and OMB regulations. Concerning policy variances outlined in this statement, agency policies must call for paying all required interest penalties voluntarily as mandated in the act.

Also, OMB and DOD should resolve whether paying the large sums involved with progress and other interim payments in the relatively short 5- to 10-day period is in the best interest of the government. Due date terms should be included in these types of agreements as new contracts are awarded and as existing agreements are amended or extended.

4. Performance assessments

Finally, it is not possible to gauge the need for management improvements without a clear picture of past performance. As noted earlier, interest payments made by agencies proved to be only the tip of the iceberg as far as late payments were concerned. Achieving an accurate overview will require OMB to expand the current reporting requirements to include summary data on all payments occurring after the due date.

Mr. Chairman, these initiatives cannot be conducted on an ad hoc basis. A key to achieving real and lasting progress will be a collaborative effort in which OMB takes a central role. Any successful plan will have to include all of the agency activities involved both directly and indirectly in the acquisition and payment process.

If these broad goals are tackled cooperatively, I believe that we can further improve the government's performance and erase the perception that the government does not consistently pay on time. Surely, as the Congress concluded when it passed the act, it is reasonable to assume that a good payment record would heighten competition for selling goods and services to the government and yield side benefits such as more attractive prices. Our report, containing the overall evaluation of agencies' compliance with prompt payment requirements, will be completed next month.

This concludes my formal remarks. I will be pleased to answer any questions you or other members of the Subcommittee may have.