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The Honorable F. Edward Hebert  
Chairman, Committee on Armed Services  
House of Representatives

R Dear Mr. Hebert:

This report responds to your request of January 18, 1973, that the General Accounting Office provide you information on the techniques available for financing defense contractors and defense projects.

The Government may provide financing to defense contractors under all types of contracts through the guaranteeing of loans made by lending institutions and through advance payments. It provides financing under fixed-price contracts by making progress payments, and it pays contractors under cost-reimbursement contracts as costs are incurred.

During and up to 6 months after national emergencies, certain agencies may, in the interest of national defense, modify contracts by such methods as increasing contract prices or changing delivery terms without regard to certain other restrictions applicable to the award and administration of contracts.

GUARANTEED LOANS

Guaranteed loans are similar to other loans made by lending institutions, except that the Government assumes certain risks by obligating itself to purchase an agreed portion of the loan from the lending institution, such as when the contractor defaults or when it appears that he may default. These loans are made and administered by the lending institution.

Under the Defense Production Act of 1950, as amended (50 U.S.C. 2091), and Executive Order No. 10480, as amended, the Departments of the Army, Navy, and Air Force; the Defense Supply Agency; the Atomic Energy Commission; the General Services Administration; and the Departments of Agriculture,

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Commerce, and Interior are authorized to guarantee loans, called V-loans, to contractors having products or services essential to national defense and for whom private lending institutions will not provide necessary financing without a Government guarantee.

Since August 15, 1970, the amount which may be guaranteed by an agency to a contractor under the act has been limited to \$20 million without approval by the Congress. The maximum amount of the guarantee and the period covered are to approximate the contractor's financing needs for defense production contracts on hand at the time of application. Also, guarantees are to be limited to 90 percent of the contractor's investment in certain assets acquired for use in defense production contracts.

As of June 30, 1972, the Department of Defense (DOD) portion of loans made under the act amounted to \$3.4 million. During recent years few guarantees have been made and loan activity under the act has consisted primarily of liquidating existing guarantees. Data regarding the outstanding DOD portion of loans under the act as of June 30, 1970, 1971, and 1972, is contained in enclosure I.

#### ADVANCE PAYMENTS

An advance payment is money the Government pays to prime contractors before complete performance of a contract, or group of contracts, without regard to progress made or costs incurred. Advance payments have also been made to local and foreign governments which use the funds to provide goods and services to the U.S. Government.

Advances are liquidated from payments otherwise due to the contractors through performance of contracts. The Government's policy is to make advances only when no other reasonable source of financing is available to the contractor.

Advance payments by DOD are authorized under the Armed Services Procurement Act of 1947 (10 U.S.C. 2307) and under the Act of August 28, 1958 (Public Law 85-804). Advances may also be made by the Navy under the Act of May 4, 1948 (10 U.S.C. 7364), for salvage operations.

Advances by DOD on nonprofit contracts, such as certain contracts with nonprofit organizations or local or foreign governments, or contracts for the operation of Government-owned, contractor-operated plants may be made

without interest charges. Interest is charged to other contractors at rates established by the Treasury Department to reflect the Government's borrowing costs. The current rate of interest for advances to contractors is 7-1/8 percent.

Advances are limited to the contract price, less the amounts of advances and other payments which have been made. Advances are disbursed to a contractor through special bank accounts, and withdrawals are countersigned by a Government contracting officer. Advanced funds are to be used only for expenses incurred in the performance of the contracts for which advances were made.

In order to protect its interest, the Government may prohibit the contractor from taking actions without its consent, such as paying dividends, disposing of certain assets, increasing the salaries of officers and key personnel, or making substantial changes in the management of the company.

As of June 30, 1972, advance payments outstanding by DOD amounted to \$188 million, of which \$123 million was to the government of the United Kingdom for purchases of Harrier aircraft and \$52 million was to nonprofit organizations and local and other foreign governments. Data regarding the amounts of advances outstanding by DOD as of June 30, 1970, 1971, and 1972 is contained in enclosure II.

#### PROGRESS PAYMENTS

Progress payments, made by DOD to contractors as work progresses under fixed-price type contracts, are authorized under the Armed Services Procurement Act of 1947 (10 U.S.C. 2307).

Progress payments on contracts for shipbuilding (including ship conversions, alterations, or repairs) and for construction of buildings and other real property, are based on a percentage of completion or on the stage of completion of the items contracted for. For other types of items, progress payments are based on the contractor's costs under the contract.

Shipbuilding progress payments are made at 90 percent of the physical progress completed during the first half of construction and at 100 percent of the physical progress completed during the second half. Unliquidated progress payments outstanding on a shipbuilding contract may not exceed costs incurred on undelivered items, plus an agreed-upon percentage of such costs not exceeding 10 percent.

As of June 30, 1972, unliquidated progress payments for Navy shipbuilding contracts amounted to \$2.6 billion. Data regarding the amounts of unliquidated progress payments on Navy shipbuilding contracts at the close of fiscal years 1970, 1971, and 1972 is contained in enclosure III.

Progress payments for construction are made at up to 90 percent of (1) the amount determined by applying the percentage of completion to the contract price or (2) the portions of the contract price assigned to various stages of contract completion. The amount of unliquidated progress payments outstanding may not exceed the amount of costs incurred on undelivered items, plus 10 percent of such costs or the percentage of such costs equal to the anticipated profit rate under the contract, whichever is less.

Progress payments for items other than shipbuilding and construction are based on costs and may be made when the time between the beginning of work and the delivery of the first item will be 6 months or more (4 months or more for small businesses). As a general rule, progress payments are not made to other than small businesses if the contract is for less than \$1 million.

For contracts entered into on or after March 1, 1968, progress payments made on a cost-incurred basis have been made at 80 percent (85 percent for small businesses) of the contractor's total in-plant costs, plus the amount of progress payments made to subcontractors. Progress payments at higher rates, called unusual progress payments, may be made if the contractor's performance under the contract requires a preparation period in which predelivery expenditures are large in relation to the contract price and in relation to the contractor's working capital and credit. Unusual progress payments have generally been made at 90 percent of total costs.

The amount of unliquidated progress payments outstanding made on a cost-incurred basis may not exceed 80 percent (85 percent for small businesses) of the cost or price of undelivered items, except when arrangements for unusual progress payments have been made. These progress payments are liquidated either by deducting from the contractor's bills for delivered items a percentage equal to the rate of progress payments which have been made or, under an alternate method, by subtracting from the contractor's bills an amount approximating the progress payments which had been made on the delivered items. Under the one method, until progress payments are liquidated, a contractor is paid only a nominal portion of the estimated profits earned on delivered items;

under the alternate method, at each delivery a contractor is paid the estimated profits earned on the delivered items.

As of June 30, 1972, DOD's unliquidated progress payments, based on incurred costs, amounted to \$4.4 billion. Data regarding DOD's unliquidated progress payments, based on incurred costs as of June 30, 1970, 1971, and 1972, is contained in enclosure III.

#### EMERGENCY CONTRACTUAL RELIEF

Under Public Law 85-804 (50 U.S.C. 1431) and Executive Order No. 10789, DOD and certain other agencies have broad authority during national emergencies to increase contract prices without consideration and to make advance payments on them. A presidentially declared state of national emergency has been in effect since December 16, 1950.

DOD has established contract adjustment boards to receive requests for relief from contractors and to approve payments to the contractors. During 1971 the boards allowed price increases amounting to \$629 million, of which \$623 million represented price increases under contracts with Lockheed for the C-5A aircraft and the AH-56A Cheyenne helicopters. During 1969 and 1970 the boards allowed price increases of \$2 million and \$4 million, respectively.

#### COST REIMBURSEMENTS

Cost reimbursement is used to finance cost-type contracts. Contractors are paid 100 percent of their total in-plant costs, plus the amounts paid to subcontractors. At periodic intervals during performance of a contract, the contractors are paid a portion of the estimated fee due at the completion of the contract.

Payments on cost-type contracts amounted to approximately \$8.7 billion during fiscal year 1970. The amounts applicable to more recent years are not readily available.

#### OTHER FINANCIAL ASSISTANCE

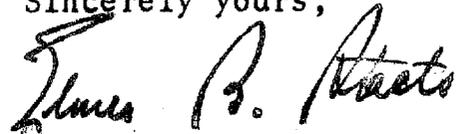
The Government also assists defense contractors and subcontractors by furnishing Government-owned facilities and equipment for their use, by granting tax advantages, by permitting contractors to assign future payments under

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Government contracts to lending institutions, by granting other types of loan guarantees, and by giving preference in contract awards to suppliers which are small businesses or which are located in labor surplus areas. However, the Government does not generally consider these types of assistance to be contractor financing, and they are generally not limited to defense contractors.

We trust that this responds to your request. We are studying the Government's contractor financing activities and will provide you a copy of our report.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "James B. Argets".

Comptroller General  
of the United States

DOD PORTION OF  
OUTSTANDING DEFENSE PRODUCTION ACT LOANS

	As of June 30		
	<u>1970</u>	<u>1971</u>	<u>1972</u>
	_____(millions)_____		
Army	\$0.5	\$0.5	\$0.5
Navy	2.9	3.1	2.6
Air Force	1.1	1.0	0.3
Defense Supply Agency	-	-	-
Total	<u>\$4.5</u>	<u>\$4.6</u>	<u>\$3.4</u>

## ADVANCE PAYMENTS OUTSTANDING BY DOD

	As of June 30		
	<u>1970</u>	<u>1971</u>	<u>1972</u>
	<u>(millions)</u>		
Army	\$ 3.3	\$ 2.5	\$ 1.7
Navy (note a)	60.7	72.3	162.9
Air Force	26.8	26.1	23.1
Defense Supply Agency	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$90.8</u>	<u>\$100.9</u>	<u>\$187.7</u>

<sup>a</sup>Includes the Marine Corps.

## UNLIQUIDATED PROGRESS PAYMENTS OUTSTANDING BY DOD

	As of June 30		
	<u>1970</u>	<u>1971</u>	<u>1972</u>
	<u>(millions)</u>		
SUPPLY CONTRACTS:			
Army	\$ 942	\$ 718	\$ 494
Navy	2,370	2,169	2,040
Air Force	4,693	2,516	1,845
Marine Corps	12	6	6
Defense Supply Agency	9	13	11
Total	8,026	5,422	4,396
SHIPBUILDING CONTRACTS:			
Navy	<u>1,814</u>	<u>2,301</u>	<u>2,648</u>
Total	<u>\$9,840</u>	<u>\$7,723</u>	<u>\$7,044</u>