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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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

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Dear Mr. Chairman:

Our letter to you of March 21, 1973, discussed the various techniques the Department of Defense (DOD) used to finance its contractors. In that letter, we described the types of financing and included statistics on the amounts of unliquidated progress payments, advance payments, and guaranteed loans outstanding to DOD contractors. We also advised you that we were looking into the Government's contractor-financing activities in greater depth and that we would provide you with a copy of our report.

We have now completed our inquiries into the Government's contractor-financing activities and have concluded that the area does not at this time warrant further review and reporting since DOD has made changes to the Armed Services Procurement Regulation (ASPR) to correct certain inequities and abuses. Agency, contractor, and contractor trade association officials generally felt that the progress payment system was reasonable and had no significant suggestions for improvement.

We started the study as a broad survey of the Government's contractor-financing activities. We reviewed the amounts and types of financing provided to contractors and the types of procurements for which financing was provided. We obtained comments from agency, contractor, and contractor trade association officials and inquired into commercial and foreign government financing practices.

The Government makes financing available to its contractors when the products or services purchased require substantial amounts of time and money for contract performance. Financing of some contractors is necessary because the investment required for contract performance is beyond the credit available to the contractors from private sources. The Government's

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financing of contractors should help to maximize competition and may result in lower prices to the Government for the products and services being purchased.

Our inquiries indicated that most of the financing provided in connection with Government contracts was made by DOD and that most DOD financing was provided through progress payments. DOD has developed reporting systems providing data on progress payments made to contractors under supply-type and shipbuilding contracts. Other Government agencies did not have reporting systems showing the amounts of financing provided to contractors. Since there does not appear to be a compelling need for these types of data on the other agencies, we felt that the cost to accumulate it would exceed the benefits that might be derived.

Within the last few years, DOD has taken action to improve the progress payment system. In November 1970 the DOD Industry Advisory Council established a subcommittee to study DOD contractor-financing policies and practices. The subcommittee found that DOD's policy of basing progress payments for subcontract costs on obligations as distinguished from costs paid out could result in the Government's supplying cash exceeding a contract's needs and that inequities existed because some contractors were receiving progress payments more frequently than others. The Council found also that the more frequent the progress payments the lower investment the contractor had in inventories.

As a result of that study, DOD revised ASPR in January 1972 to provide that progress payments be made on the basis of cash payments for subcontract and materials costs rather than on accrued costs and that progress payments be made no more frequently than biweekly. A further revision to ASPR in July 1973 provided that a contractor be permitted to recover through progress payments and cost reimbursements only cash contributions made to a pension fund within 30 days from the end of a calendar quarter. This revision was made to prevent contractors from receiving financing for pension fund costs considerably in advance of making payments to the pension funds.

The foreign governments to which we made inquiries financed their contractors in connection with certain types of large

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government contracts, such as defense and construction contracts. The financing that they provided was similar to that provided by this country--progress payments, advance payments, and loan guarantees.

In certain types of commercial transactions, the prepayment method of financing is common practice and requires much less administrative effort than the Government's progress payment system. But the use of commercial techniques by the Government appears impractical because of frequent changes to Government contracts during contract performance and because agencies generally feel a need to have assurances that progress payments made are reasonable in relation to costs incurred by the contractor. We noted also that agency, contractor, and contractor trade association officials generally felt that the progress payment system was reasonable and that they had no significant suggestions for improvement.

We trust that this information will assist you.

Sincerely yours,

Comptroller General
of the United States