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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Mayor Of The District Of Columbia

The District Of Columbia Can Pay More Vendors On Time

GAO estimates that in fiscal year 1981 only 28 percent of the District's bills were paid within 30 days because District agencies were slow in processing payment documents. As a result, about $383,000 in purchase discounts were lost. Late payments also cost vendors an estimated $612,000 for lost investment income or borrowing expenses. The District has eliminated the problem of late payment of utility bills and is now developing procedures to ensure that investment income is not lost by paying too early. GAO makes several recommendations to emphasize the importance of paying bills on time, to standardize the payment process, and to monitor payment performance against time standards.

UNITED STATES GENERAL ACCOUNTING OFFICE

GAO/GGD-83-38
APRIL 1, 1983

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

The Honorable Marion S. Barry, Jr.
Mayor of the District of Columbia
Washington, D.C. 20004

Dear Mayor Barry:

This report identifies problems the District of Columbia is experiencing in making timely payments to vendors and estimates costs to both the District and its vendors and recommends specific actions to improve the timeliness of payments and the management of the vendor payment system.

This report contains recommendations to you on pages 19 and 20. As you know, the Mayor is required, within 90 days after receiving our audit report, to state in writing to the District Council what has been done to comply with our recommendations and to send a copy of the statement to the Congress (31 U.S.C. §715(c)(1), as recently codified by Public Law 97-258, formerly section 736(b) of the District of Columbia Self-Government and Governmental Reorganization Act, Public Law 93-198). The Mayor is also required to report, in the District of Columbia's annual budget request to the District Council, on the status of efforts to comply with such recommendations (Section 442(a)(5) of Public Law 93-198).

We are sending copies of this report to interested congressional committees; the Director, Office of Management and Budget; and to each member of the Council of the District of Columbia.

Sincerely yours,

W. J. Anderson

William J. Anderson
Director

REPORT TO THE MAYOR OF THE DISTRICT OF COLUMBIA

THE DISTRICT OF COLUMBIA CAN PAY MORE VENDORS ON TIME

D I G E S T

The District Government has been criticized repeatedly over the years for not paying its bills on time. Numerous examples of problems caused by late payments have been cited, but how frequently the District pays late and how late the payments generally are has not been reported.

GAO estimates that in fiscal year 1981 the District government lost $383,000 in purchase discounts because bills were not paid on time. The results of GAO's analysis of vendor payments also showed that only 28 percent of the bills were paid on time--within 30 days. Seventy-two percent were late and 25 percent were paid over 30 days late. It took an average of 66 days to make a payment. (See p. 13.)

In addition to costing the District lost discounts, late payments cost vendors an estimated $612,000. Money tied up in overdue receivables is not available to cover operating expenses or for investing and might necessitate borrowing. The result is that the vendors incur costs roughly equivalent to the interest foregone on investments or the cost of borrowing. (See p. 13.)

Late payments also damage the District's reputation and may erode its competitive base, resulting in higher prices, poorer quality goods and services, and fewer discounts offered. (See p. 13.)

Other major cities place more management emphasis on timely payments and taking purchase discounts, and do a better job of monitoring payment performance. (See p. 13.)

APRIL 1, 1983

The District has eliminated the problem of late payment of utility bills, which was costing significant amounts in late charges, by centralizing the payment function in the Department of General Services (DGS). However, this created the problem of lost investment earnings due to early payments. About $204,000 was lost in a 1-year period because utility bills were paid before the due date and funds were not available for short-term investment. This is a relatively simple problem to solve and DGS is currently developing procedures to ensure that utility bills are paid as close as possible to the due date. (See p. 17.)

The major cause of late payments is the slow processing of payment documents by District agencies. When agencies are late entering payments into the centralized Financial Management System (FMS) computer, the problem is compounded by an automatic 17-day payment delay known as the cash management policy. Since the District does not routinely monitor the payment performance of the agencies, systematic corrective action is not taken. (See p. 14.)

Centralized oversight of the payment process is lacking. Policies and procedures have not been consolidated in a single manual for agencies to use in processing payments, and time standards have not been established to gauge the payment process. Reports on the timeliness of payments and discounts lost are not available for the D.C. Controller to use in monitoring payment performance, and the Controller does not perform post audits of payment vouchers. (See p. 17.)

CONCLUSIONS AND RECOMMENDATIONS

The District is not paying its debts when due. Late payments are causing the District to lose purchase discounts and are costing vendors hundreds of thousands of dollars in lost investment income or interest expenses. Also, prices may be higher because some vendors may decide not to do business with the District thereby reducing competition. Vendors who usually offer purchase discounts may decide not to because it does not speed up payments. Steps need to be taken to correct slow processing of payments by the agencies and to eliminate unnecessary delays caused by the FMS cash management policy.

GAO recommends that the Mayor assign responsibility to the Office of the Controller for ensuring prompt vendor payments and require the Controller to:

--Emphasize the importance of agencies processing payments quickly so bills can be paid on time, and require priority handling of payments to vendors offering purchase discounts.

--Standardize all policies, procedures, and documents relating to the payment process, and consolidate them in a single, comprehensive manual.

--Develop time standards for the payment process, generate FMS reports on the timeliness of payments and on prompt payment discounts lost and taken, and monitor and report on the billpaying performance of individual agencies.

--Develop a plan to eliminate the delay caused by the cash management policy and replace it with a system that calculates due dates and schedules payments to be made when due. The plan could be implemented over a period of time to minimize the impact on cash flow.

--Perform post audits to ensure compliance with established procedures, policies, and internal controls.

--Proceed with implementation of a vendor information subsystem in FMS.

AGENCY COMMENTS

In response to GAO's request for comments the City Administrator said the District has focused greater attention at the agency level in order to improve vendor payment performance and is implementing centralized policies and standards to emphasize timeliness. He expressed general agreement with most of GAO's recommendations but did not specifically address the recommendation to eliminate the delay caused by the current cash management system and schedule payments to be made when due. The text of the comments appears in appendix III and is summarized with GAO's analysis on page 20.

Contents

		Page
DIGEST		
CHAPTER		
1	INTRODUCTION	1
	Importance of timely payments	1
	Past problems with billpaying	2
	Overview of the District's vendor payment process	3
	Objectives, scope, and methodology	5
2	PAYMENTS TO VENDORS ARE OFTEN UNTIMELY	7
	A significant number of payments are late	7
	FMS cash management policy contributes to delays	16
	Weak central controls perpetuate the problem	17
	Early payments are also costly	17
	A vendor information subsystem is needed	19
	Conclusions and recommendations	19
	Agency comments	20
APPENDIX		
I	The vendor payment process in other major cities	22
II	Sampling methodology	25
III	Letter dated February 8, 1983, from the City Administrator to the Director of the General Accounting Office's General Government Division	27

ABBREVIATIONS

DGS	Department of General Services
FMS	Financial Management System
GAO	General Accounting Office
POL	Petroleum, Oil, and Lubricants

CHAPTER I

INTRODUCTION

The District of Columbia government spends millions each year in payments to vendors. It has developed a reputation of not paying on time and has received criticism from the press and District vendors. But the problem has not been adequately measured nor has its impact been quantified.

This report measures the seriousness of the late payment problem and shows what it is costing the District and vendors in both dollars and other less quantifiable damages. It is our first comprehensive review of the problem and illustrates the District's overall performance as a billpayer.

IMPORTANCE OF TIMELY PAYMENTS

Paying bills when due is important to both the District and its vendors. Good cash management dictates that bills be paid on time so that excess funds can be invested, borrowing minimized, and good relations maintained with vendors. The importance of timely payments was emphasized recently by the Congress when it passed the Prompt Payment Act (Public Law 97-177) requiring Federal agencies to pay an interest penalty on amounts owed to business concerns for the acquisition of property or services when the agency does not pay on time. Private industry is also putting more emphasis on timely payments because of high interest rates and frequent cash flow problems. Minority and small vendors are especially vulnerable to the negative effects of late payments because they may not have cash to cover operating expenses. The District's Minority Business Opportunity Commission is charged with making sure that minority businesses are paid promptly. The Commission told us that, in the past, minority vendors have been forced to borrow funds to meet payrolls because the District was late paying and one company was even forced out of business.

Paying bills early is not a good cash management policy because the District forfeits the interest that could be earned from investing the money or has to borrow to cover cash shortages. Standard business practice and the U.S. Government generally provide that bills be paid within 30 days of receiving an invoice or upon the date on which payment is required by contract. The payment should be made as close to the due date as possible.

Paying bills late creates problems for both the District and its vendors. All vendors count on timely payments to manage their cash flow. When payments are late vendors may be forced to borrow money to pay employees and suppliers. Even if they are not short of cash for operations, vendors are losing the interest the money could be earning. They are, in effect, helping to finance District government operations. Also, both the vendor and the District may be spending some employee time inquiring about and following up on late payments.

Not paying bills when due causes the District to lose purchase discounts. Many vendors offer discounts to encourage payment of bills before the date normally due. For example, a 2-percent discount might be offered for payment in 20 days. The District generally does not take advantage of the discounts because it is difficult to get payments processed in 20 days. Five other major cities we contacted consider discounts significant and make an effort to negotiate them into contracts and take advantage of them.

A less obvious negative impact of paying late is the effect on the competitive environment. Vendors resent consistently being paid late; and given the District's poor payment practices, its reputation as a customer could already be damaged. For example, some vendors may be hesitant to compete for the District's business or may refuse to compete at all. This could reduce the number of vendors the District has to choose from and possibly result in higher prices and lower quality goods and services. In addition, vendors may recognize what late payments are costing them and may inflate the price of goods and services to compensate.

PAST PROBLEMS WITH BILLPAYING

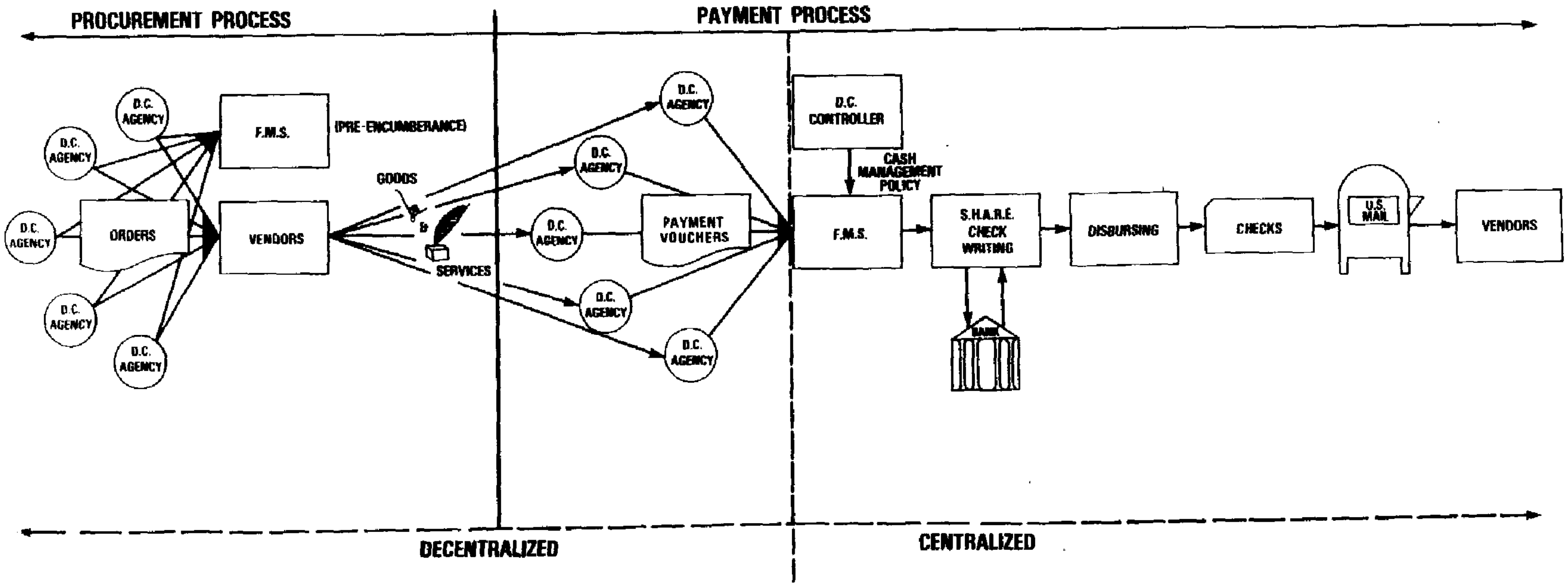
The slowness of payments to vendors is a problem the District Government has been facing for many years. In 1976 the Office of Audits concluded that the overall payment process is often unconscionably slow and recommended District-wide guidelines on how long the process should take. A "Fast Payment Committee" was organized in January 1980 to identify problems and propose solutions. The Inspector General reviewed the payment process in January 1980 shortly after start-up of the new Financial Management System (FMS). She found that the three largest District agencies took an average of 56 days to pay. Again, it was recommended that overall policies and procedures be issued. The need for such policies and procedures was further demonstrated in March 1980 when a petroleum supplier cut off fuel deliveries to city schools and other government buildings because the District failed to pay its bills.

In spite of the efforts by the Inspector General, the Office of Audits, and individual agencies, the District remains a slow billpayer. Our audit showed that only 28 percent of the bills were paid in 30 days.

OVERVIEW OF DISTRICT'S VENDOR PAYMENT PROCESS

The vendor payment process in the District follows a decentralized procurement process. The flow chart on the following page is a general representation of the transition from procurement to payment.

THE VENDOR PAYMENT PROCESS IN THE DISTRICT OF COLUMBIA



After goods are delivered, agency accounting offices match receiving reports, invoices, and purchase orders and prepare payment vouchers. Agency data processing personnel or User Services, a data assistance department, inputs payment voucher data into the centralized FMS using local computer terminals. The District Controller determines the cash management policy which automatically delays payment a specified number of days. Following this automatic delay, a magnetic tape of checks to be written is sent to the bank. The bank uses the check writing magnetic tape to write the checks, then returns the checks to the District. Once completeness and accuracy are ensured, the checks are mailed to the vendors. This entire process, beginning with the date of receipt of the vendor's invoice and ending with the payment date, should take no longer than 30 days. The actual elapsed time and concurrent problems of processing vendor payments are discussed in chapter 2.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was done because the District has a history of poor bill paying performance. Our objectives were to determine whether the District pays its bills on time, how much is lost in foregone discounts, and what causes late payments.

This review covers District payments to vendors and includes the centralized payment subsystem of the FMS and the payment processing systems within eight agencies. Vendor payments are defined in the context of specific object classes such as equipment, supplies, services, etc. It does not include the payroll system, travel, debt service, reimbursements, entitlement payments, depreciation, or other nonvendor payments.

We selected a random sample of 500 payment voucher packages from fiscal year 1981 to determine how long payment took and to identify the problem areas in the process. The source of the sample was a computer listing of all voucher entries supplied by the District. We could not locate 23 of the voucher packages and dropped them from the sample. We reviewed each payment voucher package and collected data on dates of processing steps and internal controls. The 500 sample vouchers came from 36 District agencies, and we projected the results to estimate District-wide payment performance. The sample is not, however, representative of each of the 36 individual agencies. We reviewed utility payments, made centrally through the Bureau of Material Management, separately.

We also interviewed District officials and reviewed pertinent documents in the payment process in eight major agencies and the Office of Financial Management. To develop a better perspective and ensure objectivity, we obtained information on vendor payment systems in five other major cities (see app. I).

Problems encountered in conducting the audit

We encountered problems in performing this audit that indicate weaknesses in the District's management of its vendor payment system. Policies, procedures, and standards; tools for monitoring performance; and post audits are essential for identifying and correcting problems. Clear policies and uniform procedures have not been established in the District, reports on payment performance are not prepared, existing procedures are not always followed, and the post audit function is not being carried out. As a result, there is no centralized oversight to monitor how well the District is performing as a billpayer and to identify problems causing late payments.

Although it did not affect the validity of sample results, the lack of a clearly established audit trail, in many instances, made reviewing individual payments difficult. Procedures for processing payments vary among the agencies. Different filing systems are used, and the files are frequently incomplete. Standard forms and procedures have not been developed for reporting receipt under some types of purchasing. Numerous errors and omissions in the files made tracing payment histories difficult.

In many of the cases we reviewed, we were not able to determine specifically why a payment was late. The agencies do not always use the same processing procedures, forms, and filing systems. Files often did not provide enough information to trace transactions in detail through the payment process. Most offices did not routinely date stamp incoming documents. While we generally knew when a receiving report or payment voucher was prepared, we did not know when it arrived at a particular step in the process. We were able to obtain a beginning date, an FMS entry date, and a check date in 64 percent of the cases so that we could determine how much of the delay was due to agency processing--the decentralized portion of the payment process--and how much was due to automated processing--the centralized part of the process. Determining all the specific reasons for delays in processing within each agency will have to be done agency-by-agency on the basis of individual agency payment performance. The problems cited in our report are based on the sample results and observations in eight agencies.

CHAPTER 2

PAYMENTS TO VENDORS ARE OFTEN UNTIMELY

Our analysis of payment transactions showed that the District is doing a poor job of paying vendors on time. We estimate that 72 percent of the payments were late and 25 percent were over 30 days late. Late payments caused the District to lose an estimated $383,000 1/ in purchase discounts, caused vendors to suffer cash flow problems, and cost vendors an estimated $612,000 in short term investment earnings or interest cost on borrowing. 2/

The District's new Financial Management System (FMS) provides increased opportunities to monitor and improve payment performance. To take advantage of these opportunities, District managers will have to emphasize the importance of paying on time and exercise more centralized oversight of payment system operations in the agencies.

The primary reasons for the slow payment problem are (1) delays in the manual payment processing systems within the agencies and (2) the FMS cash management policy which automatically delays payments a specific number of days after processing is completed. The five other major cities we visited have a single, central unit that handles most of the billpaying functions and, as a result, they have a more standardized process and more central control than the District. They have problems, like the District, getting departments to process receiving reports quickly, but none of the cities have an automatic payment delay like the District's cash management policy.

A SIGNIFICANT NUMBER OF PAYMENTS ARE LATE

The District paid only 28 percent of its bills on time and lost almost $400,000 in purchase discounts in fiscal year 1981. Some discounts were taken, but the number in our analysis was too small to be projected. In addition, late payments

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1/This figure has been reduced by the amount earned in short-term investments for the period of time between the discount due date and normal due date.

2/See appendix II for sampling methodology.

cost vendors over $600,000 in lost interest earnings or borrowing expense. These costs could have been avoided.

In fiscal year 1981, the District made an estimated 95,624 separate payments to vendors. We randomly selected 500 payments for analysis to determine whether the payments were made on time and whether purchase discounts were taken. The measure of time taken to make a payment was the elapsed time between the date of the vendor's invoice (provided the goods or services had been delivered) and the date of the check. The date the vendor's invoice was received by the District could not be used because it was not recorded in most cases. Utility payments are not included in the sample because they are centrally paid by the Department of General Services, and late payment problems have been corrected (see p. 19). Twenty-three of the payments in the sample were dropped because the payment voucher files could not be located.

While the majority of payments were late, large dollar value payments were more likely to be made on time than small dollar value payments. Eighty-one percent of the vouchers paid in 15 days or less were for over $1,000. Seventy-two percent of the vouchers for over $10,000 and 44 percent of the vouchers for $5,000 to $10,000 were paid on time.

Following is an analysis of projected District-wide payment performance.

Table 1
Payment Performance
In The
District of Columbia
During Fiscal Year 1981

Days to Pay (note a)	Number of Pay-ments	Percent of Payments	Cumulative Percent of Payments	Dollar Value (000 (omitted)	Percent of Dollar Value
0-30	16,447	28.1	28.1	$185,282	73.1
31-45	16,447	28.1	56.2	27,929	11.0
46-60	11,092	19.0	75.2	20,341	8.0
61-75	4,207	7.2	82.4	1,482	0.6
76-120	4,781	8.1	90.5	3,291	1.3
120+	5,546	9.5	100.0	15,096	6.0
Total	b/58,522	100.0	100.0	$253,421	100.0

a/Measured from the latter of the date of invoice or the date of receipt of the goods and/or services to the date of check issuance.

b/Total payment time could not be projected for about 37,000 vendor payments since in approximately 39 percent of the 500 sample cases complete vendor payment records were not available. The total does not equal the sum of the components because of rounding.

Table 2
Timeliness of Payments by Size of Payment

Size of Payment	Payments Number	Payments Percent	Paid Late Number	Paid Late Percent
$ 1-100	18,742	32	14,152	76
101-500	19,507	33	15,300	78
501-1,000	6,502	11	4,972	77
1,001-5,000	9,371	16	5,929	63
5,001+	4,398	8	1,721	39
Total	a/58,522	100	42,074	72

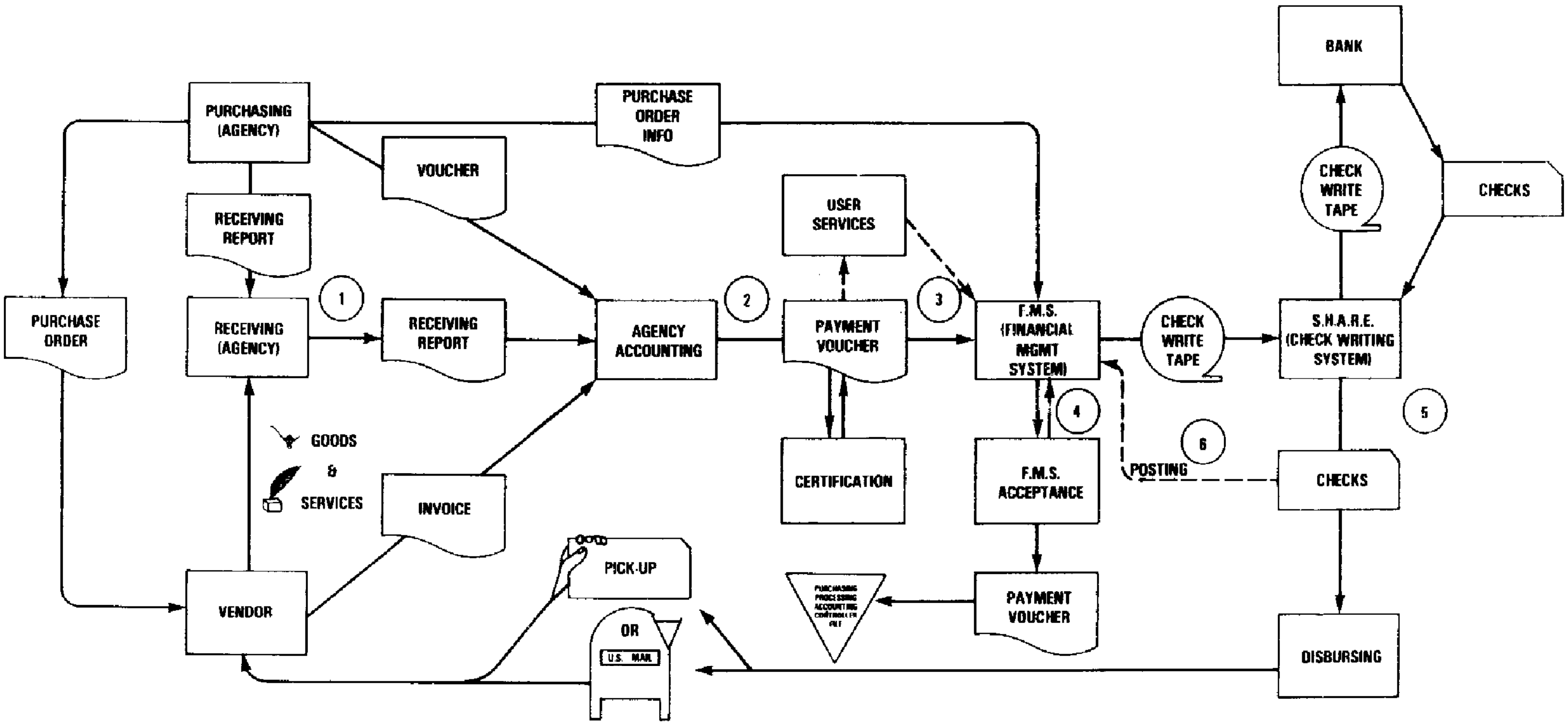
a/The total does not equal the sum of the components because of rounding.

Our analysis of vendor payments was designed not only to show the magnitude of late payments in number and dollar volume but also to measure the average time required for each step of the payment process against what we believed to be a reasonable time. The following table shows the results of the sample which are keyed, by number, to the flowchart on page 12. Unfortunately, some segments could not be reliably measured because not enough data was available. For example, the time elapsed between preparation of receiving report and its arrival in the agency accounting office could not be measured because in most cases the receiving reports were not stamped with the date of their arrival.

Payment
Processing Steps

Key	Payment Process Step	Time Required
1)	Time between receipt of goods and/or services and preparation of the receiving report.	Average time is 17 days. In 49 percent of the cases, it took over 3 days.
2)	Time between the later of: date goods received, or date of invoice, and the preparation of the payment voucher.	Average time is 34.8 days. In 83 percent of the cases, it took more than 3 days.
3)	Time between payment voucher preparation and payment voucher entry into FMS.	Average time is 7.8 days. In 55 percent of the cases, it took over 3 days.
(2 & 3)	Time between the later of: date of goods received or date of invoice and entry of the payment voucher into FMS.	Average time is 42.7 days. In 66 percent of the cases, it took more than 15 days.
4)	Time elapsed from FMS entry to acceptance (primarily time required for correction of entry errors).	Average time is 2.6 days. In 83 percent of the cases acceptance was within 3 days.
5)	Time elapsed between date of FMS entry and check issuance.	Average time is 20.6 days. In 80 percent of the cases, it took between 17 and 21 days.
6)	Time elapsed between check issuance and posting to FMS.	Average time is 7.9 days. In 82 percent of the cases, it took more than 3 days.
7)	Total payment time measured from the later of date goods received or date of invoice to date of check.	Average time is 66 days.

CRITICAL STEPS IN THE DISTRICT'S VENDOR PAYMENT PROCESS



Late payments cause discounts to be lost

By paying bills late the District loses purchase discounts offered by vendors to encourage early payment of bills. Although the District has a policy of taking discounts (Mayor's Memorandum 79-154 issued Sept. 14, 1979), most District agency officials told us they do not attempt to take discounts because they cannot make payments on time. In one case, $5,040 was lost on a single payment of $252,000 because the payment was made 23 days past the discount date.

Our analysis estimated that the District lost $383,000 in purchase discounts in fiscal year 1981. We estimate that over 12,000 vendor invoices included discounts, but the District seldom took advantage of them. Only about 13 percent of the vendor payments offered purchase discounts, but the amount is significant and could probably be increased if the District aggressively followed a policy of taking advantage of the discounts offered and actively soliciting discounts on new contracts and purchase orders. The practice of paying late discourages vendors from offering discounts and might cause them to raise prices to compensate for the cost of late payments.

The five other major cities we visited told us they placed a great deal of emphasis on negotiating and taking discounts. While most did not keep records of how much was saved, Los Angeles reported taking 70 percent of the discounts offered in one quarter of 1982. San Francisco took about 90 percent of the discounts offered during a 2-month period in 1982. We also spoke with officials of the General Services Administration's Federal Supply Service and were told that in fiscal year 1981, 77 percent of the supply schedule contractors offered purchase discounts.

Late payments damage the District's reputation as a bill payer and discourage vendors from offering purchase discounts. Although measuring total costs is difficult, late payments may discourage vendors from seeking additional contracts with the District and competition may be reduced resulting in higher prices and lower quality goods and services.

Late payments are costly to vendors

It would be difficult to measure the impact of late payments on vendors' cash flow, but late payments can create hardships for vendors in meeting operating expenses, especially for the small and minority businesses which depend on the District for a major portion of their sales. A number of agency officials and several vendors told us they were aware of instances where vendor operations were adversely affected by late payments.

Late payments cost vendors lost investment opportunity and the price of borrowing to meet cash needs. Using the fiscal year 1981 average Treasury Bill rate of 15.08 percent, we estimated the cost to be $612,000 to vendors doing business with the District in fiscal year 1981. The Federal Government recently passed the Prompt Payment Act (Public Law 97-177) effectively requiring Federal agencies to pay an interest penalty at a rate set by the Department of the Treasury on bills not paid by the statutorily prescribed date. The law does not apply to the District, but it illustrates the importance that should be placed on timely payments.

Problems in agencies' processing cause delays

Agencies are clearly not performing as well as they should in processing vendor payments. It takes an average of 42.7 days for a payment to be processed and entered into FMS. The Accounting Division of the Department of General Services (DGS) monitored the processing of a sample of payments on several occasions in 1982 within the Department. For those studies, they set 6 days as the standard for the maximum amount of time allowed for processing the payments within the Department. Although the studies showed that the Department generally did not meet the 6-day limit, it seems a reasonable standard for preparing a receiving report and a payment voucher, performing a preaudit, and entering a payment into FMS. Our review showed that only 34 percent of all payments reached FMS in 15 days or less. Thirty-six percent of payments took over 30 days to reach FMS. Payment vouchers were prepared within 10 days in 39 percent of the cases, but it took over 30 days in 24 percent of the cases and the average time was 35 days.

The most common complaint among agency accounting offices is that it takes too long for the people who receive goods and services to complete and submit receiving reports. Our sample showed that it took an average of 17 days to prepare a receiving report. The other major cities we visited also cited this problem as the most frequent cause of delayed payments. One reason for this problem is that completing and submitting receiving reports is the most decentralized part of the process and, therefore, is difficult to control. Some agencies have central warehouses where most goods are received; but others, such as the Public Schools, may have hundreds of receiving locations spread throughout the city. The large number of locations and people involved makes monitoring difficult.

Often the people responsible for filling out the receiving report are the users; thus, their primary interest is securing the goods and services.

The absence of a standard receiving report form at receiving locations may also hamper the payment process. A standardized form for reporting receipt of goods and services is only available for purchase order acquisitions. For other types of purchases, different agencies have developed different techniques and forms for reporting receipt. DGS has printed pads of blank receiving report forms which are kept at various receiving locations which should improve the payment process in that agency. But District-wide procedures for reporting receipt of goods and services for the various types of purchases need to be developed in instances where no purchase order receiving report is available.

Payments on which purchase discounts are offered should receive priority handling so that they can be paid within the discount period, but we found little evidence that they do in the District. Other cities use various methods to "tag" discount payments to ensure that they get priority processing. One city has a discount clerk who processes all such payments.

Most of the major agencies' officials said that although FMS downtime--the amount of time the terminals are not available for agency use--is a problem which delays entry of payment data and thus slows payment processing, it is being reduced. According to data from the Office of Financial Information Services, downtime measured between June 20 and September 11, 1982, averaged only 7 percent of the scheduled available time. The sample showed that in fiscal year 1981 it took an average of 7.8 days from the time the payment voucher was prepared to the time it was entered into FMS. Twenty percent took over 10 days. Downtime may account for a portion of that delay.

Problems in agency processing which cause payment delays vary among the agencies for several reasons. There are no District-wide standards governing the payment process, and agencies have developed different procedures for processing payments. Also, since the agencies perform different functions, they buy different types of goods and services. Processing payments takes more time for some goods and services than for others. The general rule of allowing 30 days for payment can be applied in most cases; however, it is not applicable for all commodities and services. For example, some equipment purchases may require time for testing before acceptance. The most effective way to identify and correct the problems causing delays is to monitor agency performance and review individual agency payment processes.

FMS CASH MANAGEMENT POLICY CONTRIBUTES TO DELAYS

The centralized and automated portion of the vendor payment system also contributes to late payments. The sample results showed that it took an average of 20.6 days from the time a payment was entered into FMS to the date of the check. Only about 14 percent of the payments were made in under 17 days. The system is designed so that payments entered into the system are held a certain number of days, and then payment is automatically made. The time the vouchers are held is referred to as the "cash management policy." Its purpose is to prevent early payments, and it can be changed to meet cash management needs and to ensure that payments generally are made on time. If the automatic delay combined with the average processing time in the agencies is greater than 30 days, most payments will be late. There is a provision for scheduling payments to override the cash management policy and for issuing manual checks when the need arises, but these provisions are for exceptions and not for routine payment processing.

During most of the time covered by this audit, the delay was set at 17 days. Increasing the cash management policy holding period is an effective technique for delaying payments to temporarily increase balances in cash accounts and make forecasting easier. While we recognize it may help solve cash flow problems in the short run, it has a negative impact on the timeliness of payments. Eliminating the cash management policy would temporarily cause a large drain on the District's cash because the backlog of payments would be made quickly rather than over a 17-day period. It may not be as severe as one might predict, however, since it appears that large dollar vouchers are paid more quickly than the small ones, possibly through scheduled payments. A logical approach to reducing the payment delay caused by the cash management policy would be to shorten the delay over a period of time to minimize the impact on cash flow.

None of the other cities we visited have anything similar to the cash management policy. The Controllers generally processed payments as quickly as possible with no built-in delays. Since they recognize that getting the necessary documentation into the central disbursement facility on time is a problem, they reason that the central facility should pay as quickly as possible to ensure that payments are timely. One city has a system which schedules payments to be made on the date due, automatically calculated from the date of receipt of goods. We recognize that scheduling payments to be made on due dates may occasionally create cash management problems since large payments may be scheduled a short time after system entry, but in terms of timeliness of payments, it is an excellent technique.

WEAK CENTRAL CONTROLS PERPETUATE THE PROBLEM

The District does not have standard policies and procedures for the payment process consolidated in a single document. Some agencies have written, detailed procedures and some have none. Most agencies follow the procedures in the Agency Purchasing Procedures Manual, but it was designed primarily as an FMS users guide and has not been updated. We noted that the manual does not prescribe standard methods for certifying receipt of goods, except in the case of purchase orders, and does not require that incoming documents be date stamped to help identify delays and to create an audit trail. Also, it does not specify time standards for the various phases of the payment process. All this results in a lack of criteria to use in monitoring the payment process and agencies following a variety of different procedures.

In addition, the tools needed to monitor payment performance are not in place. The District does not generate routine reports documenting the amount of time agencies take to make payments or the dollars saved by taking prompt payment discounts, although FMS is capable of producing such reports. The D.C. Controller's office does not do post audits of payment vouchers to ensure that controls are followed and to discover the causes of payment delays.

Some voucher packages are missing documents, and many forms are incomplete. Forty-one percent of the voucher packages in the sample did not have a signature clearly attesting to the receipt of goods or services. We did not look beyond the payment voucher package for evidence of receipt. Only nine of the sample packages had discount terms listed on the payment voucher even though discounts were offered in 63 cases. In 20 percent of the cases, the date of receipt of goods or services was not listed, and in 64 percent of the cases the invoice was not date stamped when received by the agency accounting office.

EARLY PAYMENTS ARE ALSO COSTLY

It is a fundamental principle of good cash management that bills be paid when due and only when due. Paying bills early causes the District to forego short term investment earnings. We found that about $204,000 in interest could have been earned in a 1-year period on money that would have been available for short-term investment if utility payments had been made on the due date rather than early. 1/

On November 30, 1979, the Mayor gave DGS the responsibility for the direction and supervision of the District's electric, gas, and miscellaneous utility payments. Prior to this change, utility bills were paid individually by each District agency, and most were paid late. DGS began paying the District's gas and electric bills in March 1980 and its petroleum, oil, and lubricant (POL) bills in March 1981.

Electric payments disbursed during December 1980 through November 1981 totaled $30,210,799. The payments on the average were made 7 days prior to the billing due date. The cost of paying electric bills early during this period was $72,016.

Payments made to the Washington Gas Light Company from December 1980 through November 1981, totaled $6,238,170. The payments on the average were made 7 days prior to the billing due date. The cost of paying gas bills early during this period was $12,655.

We looked at POL payments from March 1981 through February 1982. During this period, 12 payments totaling $17,625,561 were made to various POL vendors. The payments on the average were disbursed 15 days prior to the billing due date. The cost of paying POL bills early was $119,740.

Centralizing utility payments has made a significant improvement in the timeliness of payments. No late charges have been assessed since January 1981, and significant costs have been avoided. But as our review showed, $204,413 was lost in potential investment income. During the course of this audit we brought this to the attention of the DGS Controller. He agreed that more effort is needed to pay utility bills closer to the due date and is currently developing procedures to correct the problem.

1/Electric and natural gas payments were reviewed for the period December 1980 through November 1981. Petroleum, oil, and lubricant payments were reviewed for the period March 1981 through February 1982.

A VENDOR INFORMATION SUBSYSTEM IS NEEDED

FMS was designed to contain a Vendor Information Subsystem but that capability has not yet been used. Such a system would be a valuable asset because it accumulates data on each vendor and reduces the amount of work in payment processing. The five major cities in our review all had such systems. They used them to track the amount of business being done with individual vendors, to reduce administrative work, and to facilitate information reporting to the Internal Revenue Service. Three of the cities used vendor identification systems to accumulate all payments scheduled for the day by vendor and to write one check covering all vouchers for each vendor.

The assignment of vendor code numbers by the District has apparently been a problem which has delayed implementation. We noted that other cities also experienced this problem; however, the systems are operational and provide a valuable management tool in spite of numbering difficulties.

CONCLUSIONS AND RECOMMENDATIONS

The District paid 72 percent of its vendor payments late in fiscal year 1981 and lost an estimated $380,000 in purchase discounts. In addition to lost discounts, late payments damage the District's reputation among vendors and cause vendor cash flow problems, lost interest earnings, and borrowing expenses. The primary reasons for late payments are (1) slow processing of paperwork in the agencies and (2) the FMS cash management policy which is used to extend the time cash is kept on hand.

Policies and procedures have not been consolidated in a single manual for agencies to use in processing payments, and time standards have not been established to gauge the payment process. Reports on the timeliness of payments and discounts lost are not available for the D.C. Controller to use in monitoring payment performance, and the Controller does not do post audits of payment vouchers.

We recommend that the Mayor assign responsibility to the Office of the Controller for improving District-wide vendor payment performance and require the Controller to:

--Emphasize the importance of agencies processing payments quickly so bills can be paid on time, and require priority handling of payments to vendors offering purchase discounts.

--Standardize all policies, procedures, and documents relating to the payment process, and consolidate them in a single, comprehensive manual.

--Develop time standards for the payment process, generate FMS reports on the timeliness of payments and on prompt payment discounts lost and taken, and monitor and report on the billpaying performance of individual agencies.

--Develop a plan to eliminate the delay caused by the cash management policy, and replace it with a system that calculates due dates and schedules payments to be made when due. The plan could be implemented over a period of time to minimize the impact on cash flow.

--Perform post audits to ensure compliance with established procedures, policies, and internal controls.

--Proceed with implementation of a vendor information subsystem in FMS.

AGENCY COMMENTS

The City Administrator generally agreed with our recommendations and stated that over the last year the District has focused greater attention at the agency level in order to improve vendor payment performance. At the same time, he said that the Office of the Controller is implementing centralized policies and standards to emphasize the importance of processing vouchers for payment within the generally accepted 30-day standard. A consistent policy that establishes when the 30-day period begins is being developed. Under the proposed structure of the Deputy Mayor for Financial Management, the Controller can exercise increased authority and responsibility over agency procurement activities and will determine and interpret standards for timely payments.

The City Administrator stated that special processing mechanisms such as priority handling of payments to vendors who offer substantial discounts are available but recognized the need for improvement in these processes. He said that our report did not address the issue of payment delays and lost discounts caused by inspections and verifications on large purchases. Our report does recognize that the general rule of 30 days for payments may not be applicable in all cases such as when equipment must be tested before acceptance. We continue to believe that the small number of discounts taken demonstrates that our specific recommendations to develop time standards, use FMS reports to monitor agency payment performance, and eliminate the delay caused by the cash management policy should be implemented.

The City Administrator did not specifically address our recommendation to eliminate the delay caused by the current cash management system and schedule payments to be made when due.

The Vendor Payment Process in Other Major Cities

To add balance to our review of the District's payment system and to provide ideas for improvements, we obtained information on the payment systems of five other major cities--Baltimore, Philadelphia, Chicago, San Francisco, and Los Angeles. These cities approximate the District's level of expenditures. Unlike the District, these cities have a centralized vendor payment process in which a single, central unit certifies and authorizes payments for all agencies. The central unit compares the vendor's invoice with the original contract or purchase order and the receiving report. (In the District, each agency determines if a bill is correct and certifies payment.)

Each of the cities we visited also has a centralized procurement process. Agencies forward requisitions for goods and services to a central purchasing authority that uses existing contracts or a bidding process to select vendors. Purchasing then prepares a purchase order; the finance department pre-encumbers the funds; and the vendor fills the order. The finance department matches invoices from vendors, receiving reports from agencies, purchase orders from Purchasing, and certifies the payment. Checks are then prepared and mailed to vendors.

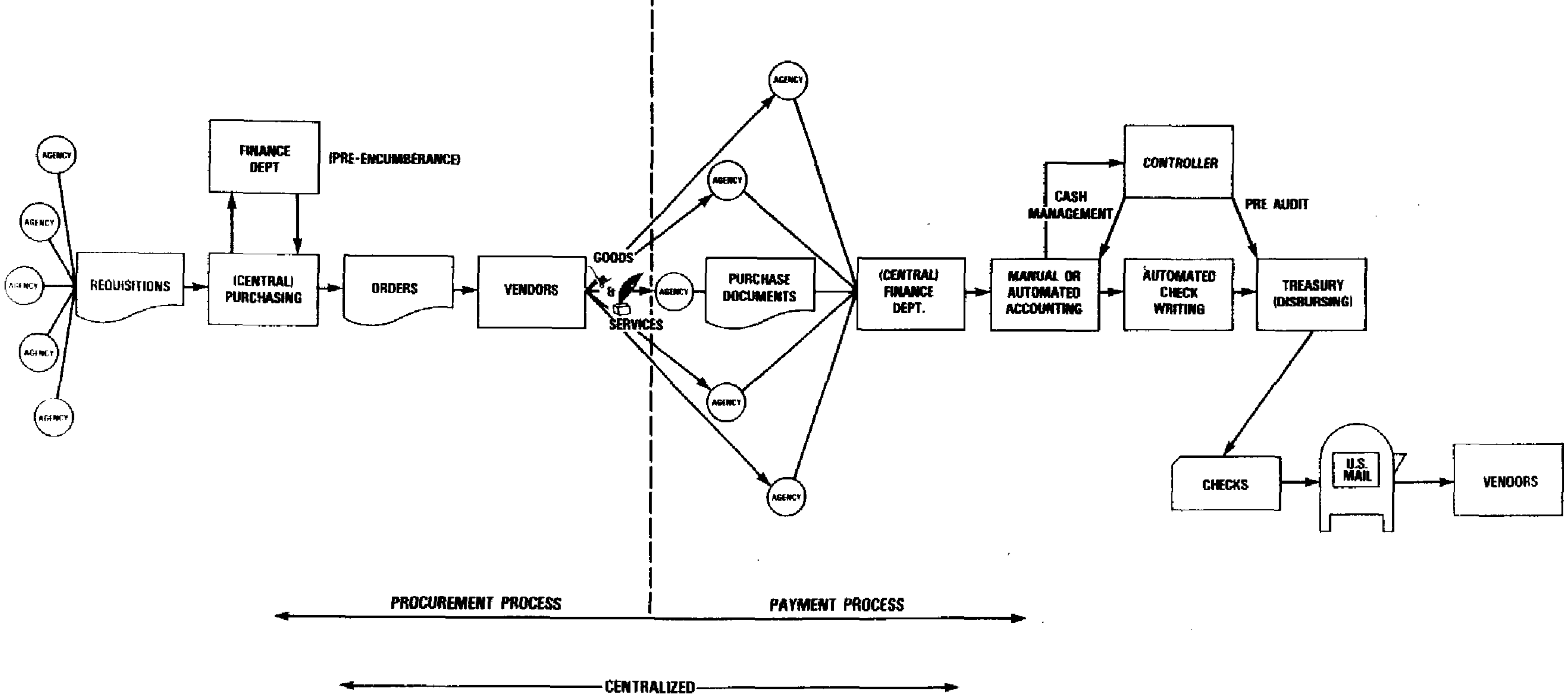
All but one city we visited had written policies concerning methods of payment and accounting procedures governing the payment process. One city in particular, Philadelphia, has an accounting manual that clearly defines the policies and procedures to be followed when processing vendor payments. In addition, the legal requirements pertaining to the city's accounting system, the organization of the Central Accounting Office, descriptions of funds and accounting, and instructions covering all accounting transactions are included in this manual.

In most cases we found that processing duties were well defined and segmented in a logical, functional order. For example, in Baltimore, there was a different section or "desk" for each accounting function. One desk checks for discounts and "flags" the paperwork to alert the supervisor that a particular payment has priority. Another desk is responsible for checking accounting codes; another is responsible for matching receiving reports, invoices, and purchase orders. In one city, through centralized accounting control, if a receiving report has not been sent to accounting in a specified period of time, an accounting clerk will contact the agency and request that it be forwarded.

All the cities had a vendor information system that consisted of a unique identification number for each vendor and a "vendor file" containing accumulated information on each vendor's performance. Baltimore, Philadelphia, and San Francisco used vendor ID numbers to consolidate all payments to the same vendor daily and thus reduce the number of checks written.

In San Francisco and Los Angeles, the Controllers monitor whether purchase discounts are taken. The Director of Finance in Philadelphia meets with agency staff quarterly to discuss accounting problems and policy changes in an attempt to streamline the accounting system. Central control and a clearly defined accounting system allow the Controllers of these cities to pinpoint problem areas in processing payments and to monitor daily revenue activity.

THE VENDOR PAYMENT PROCESS IN OTHER CITIES



APPENDIX I

Sampling Methodology

We acquired a data base tape from the Office of Financial Management from which to draw a sample. The tape, taken from the master file of all detail journal entries for fiscal year 1981, was limited to vendor payments with two types of limiting factors. First, we selected all payments of purchase orders and contracts, miscellaneous purchases, and advertising. Second, we requested only the inclusion of vouchers with selected object class codes. The object class identifies the type of goods or services being purchased. We selected object classes that most likely represent vendor payments and omitted those, such as pay, depreciation, and debt service, which obviously are not vendor payments.

The number of invoices meeting our requirements totaled 95,624. From this universe we sampled 500 payment voucher packages. The vouchers are from 36 agencies; however, because they are not statistically representative of the agencies, statistics on individual agencies do not appear in this report.

The original sample was drawn to achieve a sampling error of ± 5 percent at a 95 percent confidence level. That is, when we made a projection based on the results of our sample, we could be 95 percent certain that it would differ from the actual number by no more than ± 5 percent. However, because many cases had data missing, the sampling error on some attributes exceeded ± 5 percent. The 95 percent confidence level was maintained in all cases. The following table provides the means and sampling error for selected variables. The table can be interpreted as follows: The average time between the receipt of goods and the time the receiving report was prepared is 17 days; we are 95-percent confident that the time average is not less than 10.4 days or more than 23.7 days.

VARIABLE	MEAN	CONFIDENCE INTERVAL
Receipt of goods to receiving report	17.017 days	± 6.637 days
Voucher prepared to FMS entry	7.754 days	± 1.282 days
Voucher entry to acceptance	2.622 days	± 0.892 days
Voucher entry to check date	20.578 days	± 2.973 days
Check date to posting	7.941 days	± 0.600 days
Total payment time (note a)	65.964 days	± 9.428 days
Start date to voucher entry (note a)	42.703 days	± 7.707 days
Start date to voucher preparation (note a)	34.782 days	± 7.301 days
Projected total discount lost (note b)	$ 491,815	± $279,004
Projected total interest cost to vendors (note b)	$ 612,290	± $ 224,081
Projected total amount of payments (note b)	$192,407,199	± $60,868,990
Payments made late	72 percent	± 4 percent

a/The beginning date for these measures is the latter of date of invoice or date goods or services were received.

b/We have omitted the largest dollar value cases to avoid distortion of projections by extremes. The result is a more conservative estimate.

APPENDIX II

GOVERNMENT OF THE DISTRICT OF COLUMBIA
EXECUTIVE OFFICE

OFFICE OF THE CITY ADMINISTRATOR

ELIJAH B. ROGERS
CITY ADMINISTRATOR
1350 E STREET, N.W. – ROOM 507
WASHINGTON, D.C. 20004

February 7, 1983

Mr. William J. Anderson
Director, General Government
Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This is a response to the draft report entitled, "The District Can Pay More Vendors on Time," which was received on January 6, 1983. Over the last year, we have focused greater attention at the agency level in order to improve vendor payment performance. At the same time, we are also implementing centralized policies and standards with the Office of the Controller to emphasize the timeliness of responses. Further comments related to the recommendations are as follows:

1. In the proposed structure of the Deputy Mayor for Financial Management, the Office of the Controller can exercise an increased authority and responsibility to monitor the activities of agencies in procurement of goods and services. While the functions of procurement remain at the agency level, the Controller determines and interprets standards for timely payments, based upon a knowledge of centralized cash flow.

2. The District Controller emphasizes the importance of processing vouchers for payment within the 30 day generally accepted standard for response. A consistent policy that establishes when this time begins is being developed and communicated to agency staffs. There has been an improvement of 73% of the dollar value of payments on time.

3. The completion of a manual for District agencies and a vendor information subsystem is anticipated in the fall of 1983.

4. Priority handling of payments is given to vendors who offer substantial discounts. We recognize the need for improvement of this process. However there are occasions when inspections and vertifications are necessary on large purchases before actual payments are made, thereby losing discounts. This is a complicated issue that the GAO report does not address.

5. The District is still subject to tenuous liquidity conditions attributable to the substantial accumulated operating deficit passed on in the transition to home rule. Nevertheless, there are special payment processing mechanisms, which can be requested by vendors at the agency level and which can address more regularized payment schedules.

6. Post audits of all payment performances are not practical options. However, a method of selective auditing is more feasible.

In conclusion, I have requested the Office of the Controller to give further consideration to your recommendations concerning the standardization of vendor processing across agency lines.

Sincerely,

Elijah B. Rogers
City Administrator

(427650)

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