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

B-204733

March 17, 1982

The Honorable Jack Brooks
Chairman, Committee on
Government Operations
House of Representatives

Dear Mr. Chairman:

On November 13, 1981, you asked for our comments on H.R. 4895, an amendment to the Federal Property and Administrative Services Act of 1949. The amendment would require the Federal Government to pay interest on late payments to small business concerns. It would also provide for congressional oversight of the interest payments to small businesses and enforcement of mandatory payments within the 6 month period after completion of the contracts.

Subsequently, on January 4, 1982, you asked for our comments on a similar bill, S. 1131, cited as the "Delinquent Payments Act of 1981." This bill would also require the Federal Government to pay interest on overdue payments and to take early payment discounts only when timely payment is made, and would provide for congressional oversight of Federal bill payment performance.

Almost 4 years ago we reviewed the Federal Government's bill payment performance. Companies had complained that Federal agencies were slow in paying their bills. In February 1978 we reported our findings: "The Federal Government's Bill Payment Performance Is Good But Should Be Better" (FGMSD-78-16). We also testified in July 1977 before the Senate Select Committee on Small Business on the problems of late payments by Federal agencies.

We found that although the Government's bill payment performance was more often good than bad, lengthy delays did occur and many contractors believed they were not paid soon enough. We also found that early bill payment was a problem that was costing the Government unnecessary interest and causing some contractors to stop offering discounts. As we pointed out, it is costly to both the Government and private contractors when Federal agencies do not pay their bills when due. Costs to the Government for early payments and costs to contractors for late payments may amount to hundreds of millions of dollars annually.

Payment delays occurred for several reasons, but at least two were clearly the Government's responsibility. First, all the paperwork necessary to make payments was often slowly or not properly processed. Secondly, Government procurement regulations and standard contract payment clauses did not specify due dates and when contractor invoices included payment terms, Federal procurement and fiscal regulations were silent on whether agencies were required to abide by those terms.

In our November 24, 1981, letter to you (B-204733) commenting on H.R. 4709 ("The Prompt Payment Act of 1981"), we discussed these issues and our recommendations. In addition to the 1978 report, our letter discussed May 13, 1981, testimony before the Chairman of the Subcommittee on Federal Expenditures, Research, and Rules, Senate Committee on Governmental Affairs, and an October 8, 1981, report 1/ following up on the 1978 report. On January 26, 1982, we testified before you in support of the aim of H.R. 4709.

As discussed in our October 1981 followup report, even though we made specific recommendations almost 4 years ago, the monitoring of the Federal Government's bill payment practices has been ineffective and contract documents still do not include specific payment due dates. In this regard, the Office of Management and Budget (OMB) has since notified agencies that clear payment terms are required in all contracts and purchase orders. Also, OMB reiterated Treasury's guidelines to control timeliness of disbursements. OMB believes interest payments would shift the burdens of payment problems to taxpayers and improved management is the answer.

Avoiding late payments would resolve all these problems. However, past efforts to administratively correct the late payment problems have not been effective. Contractors still complain that they are not paid timely--a problem that has been compounded by high interest rates. By requiring interest to be paid on late payments, not only will the contractors be duly reimbursed but the specific causes for the late payments could be identified so agencies can immediately institute the corrective actions necessary to preclude additional interest charges.

We have long called for agencies to charge interest on delinquent debts owed the Government as an incentive to promote prompt payment. The same incentive should work where the Government is the debtor.

ANALYSIS OF THE PROPOSED LEGISLATIONS

As with H.R. 4709, both of the proposed bills (H.R. 4895 and S. 1131), in requiring Federal agencies to pay interest on certain

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1/"Actions to Improve Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars" (AFMD-82-1) late payments, would protect business concerns who, through no fault of their own, experience long delays in receiving payment.

Further, the bills would provide for congressional oversight by requiring Federal agencies to file annual reports. H.R. 4895, which applies specifically to small businesses, also has a requirement to have the Secretary of the Treasury make payments not made by the agency on a small business contract within 6 months after all terms of the contract have been met to improve cash flow, which is vital to small businesses.

Our 1978 report recognized the appropriateness of the Government paying interest on late payments since it would both compensate contractors for losses incurred and motivate agencies to pay bills on time. Legislation to provide for this was introduced during previous Congresses. The OMB's Office of Federal Procurement Policy opposed such legislation because the Government already had authority to require an interest clause in contracts and purchase orders. Our Office, in a 1971 decision (51 Comp. Gen. 251), held that agencies could issue regulations authorizing the inclusion of interest payment terms in contracts and purchase orders for late payments. The Office of Federal Procurement Policy, however, has not done so because of the difficulties it foresaw in implementing such a change and the administrative burden it would impose.

The ultimate solution--for the Government and the contractors--would be to improve the bill paying process so that few bills would be paid late. However, even with the most efficient payment system, given the volume of business the Government handles, undoubtedly some payments would still be made late and it is not equitable for contractors to suffer because of long payment delays caused by Federal agencies. Therefore, we support the aim of the legislation.

Although we are most sympathetic to concerns of contractors who have not received timely payments, early payment is also an important problem. Contractors have benefited from early payments, which we found to be a greater problem in dollar terms than late payments. The findings on early payments in our 1978 report were confirmed in an August 1980 report "Strengthening Cash Management in the Federal Government" prepared by the OMB. The practice of paying bills before they are due projects a favorable image of the Government as a bill payer, but is contrary to sound cash management principles. In formulating Federal payment policies the cost of borrowing must be considered along with contractor good will and the advantage of taking discounts.

Following are technical comments on the provisions of H.R. 4895 and S. 1131 for the Committee's consideration:

H.R. 4895

Payment Terms

Section 306(b)(1) requires that interest begin accumulating on payments not made 45 days after all terms of the contract have been fulfilled by the small business concern. Rather than using fulfillment of contract terms as the reference point for late payments, the Committee might consider using receipt of a proper invoice from the contractor to identify late payments.

Also, we recommended in our 1978 report and again in our 1981 report the development of payment due date standards and the use of specific payment dates in procurement documents. The variety of goods and services being purchased by Federal agencies is so wide and arrangements for making payments are so varied that it is difficult to establish a single payment standard that could be equitably applied in each case. Accordingly the Committee might consider requiring the Director, OMB to develop payment due date standards and requiring agencies to specify, when possible, in each contract and purchase order the date when payment is due.

Treasury payment 6 months after fulfillment of the contract

Section 306(c) requires the Secretary of the Treasury to pay any small business which the agency has not paid within 6 months after all the contract terms have been met.

We see the intent of this section as placing outer limits on the length of time a small business would have to wait for payment. We believe that clarifying language is needed specifying that bills are to be paid when due and that 6 months is not a normal payment timeframe.

In addition, agencies either disburse funds to pay their bills, such as in the case of Defense organizations, or provide Treasury authorization when payment is to be made. As a result, Treasury has no idea when a contract has been fulfilled but not paid. Requiring that this data be sent to the Treasury may not be administratively feasible and would create an additional administrative burden. The Committee might consider requiring agencies which make their own disbursements to pay no later than 6 months after the terms have been met on a small business contract. Similarly, agencies which Treasury makes payment for should be required to authorize Treasury payment no later than 6 months after the terms of contract have been met.

S. 1131

Discount payments

We support section 3 in calling for the Federal Government to take early discounts only when payment is made within the specified time for earning the discount. It is patently unfair to do otherwise. In a November 1980 letter, the Office of Federal Procurement Policy stressed to heads of Federal agencies to "take discounts only when merited and not after the discount period has expired."

The Committee may consider adding this provision to H.R. 4895 and H.R. 4709.

H.R. 4895 and S. 1131

Administrative burden

H.R. 4895 sec. 306(b)(1) and S. 1131 sec. 2(a)(2) as presently worded will generate significant administrative burdens. Agencies will have to develop systems for tracing documentation to determine whether the contractor or the Government was at fault in causing a late payment. Systems will also have to provide for computation and verification of any interest amounts due when paying bills. The additional costs could be substantial. Much of the additional costs could be associated with minor delays in payment which are not the real basis of concern.

Rather than mandating the Government to pay interest whenever it is making a late payment, we suggest that the bills provide for the payment of interest only upon receipt of a proper claim for interest within some designated period of time after payment of the underlying amount, say 15 days. As we testified on January 26, 1982, contractors would probably not bother submitting claims for negligible amounts of interest stemming from minor delays.

The Committee might consider adding the following language:

> "Provided that such business concern submits a statement of interest due within 15 days of receipt of payment for such property or services, which shall be subject to verification by the Federal agency."

Rate of interest payable

H.R. 4895 sec. 306(b)(3) establishes that interest is payable at "the prime rate charged by banks applicable under section 6621(c) of the Internal Revenue Code of 1954 for the calendar year in which the last day of the forty-five period * * * occurs."

On the other hand, sec. 2(d)(1) of S. 1131 states that, "Interest shall be computed at the rate determined by the Secretary of the Treasury for interest payments under section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611)."

Further, H.R. 4709, which covers payments for Government purchases, and is based on methods of interest rate computation established by the Contracts Disputes and Renegotiation Acts, uses the private commercial rate of interest for new loans maturing in approximately 5 years.

Considering the complexities and problems surrounding bill payments, we believe the Government should use the same interest rate for all late payments.

Interest limitation

In order to avoid the accumulation of large amounts of interest in situations where, for example, an invoice might be unattended because it is lost or misplaced the bill should limit the Government's interest liability to periods of 120 days beyond notifications by the contractor that contract payment has not been received. We offer the following legislation language for the Committee to consider adding to H.R. 4895 sec. 306(b)(4) and S. 1131 sec. 2(d)(2):

> ". . . but the Federal agency shall pay interest on an amount due no longer than 120 days beyond notification of the amount due provided that this limitation shall be subject to successive notifications, each good for 120 days."

Notifying the contractor of a defect in the invoice

Neither H.R. 4895 nor S. 1131 contain provisions for notifying the contractor of a defect in the invoice. The Committee may consider adding a provision such as in H.R. 4709 sec. 2(a)(2)(D) which we previously suggested be amended to read as follows:

> " . . . require Federal agencies to notify the business concern within 10 days after receipt of an invoice at the appropriate Government installation of any defect or impropriety in an invoice submitted which would prevent the running of the time period specified in subparagraph (A)(ii), and shall require Federal agencies failing to provide such notice to pay interest at the rate provided in subparagraph (b)(1) for each day after the 10 day period, until notice is given, in addition to the amount of interest that would be otherwise payable, except that

interest shall be no greater than the interest that would have been paid had the original invoice been proper."

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We appreciate this opportunity to comment on the legislation and are available should you need any future information. We are responding in triplicate as requested.

Sincerely yours,

Charles A. Bowsher

Comptroller General
of the United States

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