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WASHINGTON, D.C. 20548

OFFICE OF GENERAL COUNSEL

May 19, 1981

B-202254

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Mr. James T. Brannan
Director
Defense Acquisition Regulatory Council
Office of the Under Secretary of Defense
for Research and Engineering

Dear Mr. Brannan:

By letter of February 17, 1981, you requested our comments on proposed modifications to paragraph E-521 of the Defense Contract Financing Regulations (Defense Acquisition Regulation Appendix E) regarding milestone billing arrangements.

The purpose of a milestone billing arrangement is to alleviate inordinately high contractor financing that would otherwise result by limiting payments to customary progress payments in the performance of a defense contract with exceptionally long lead time between initiation of contract performance and commencement of deliveries of contract end items. The stated objective of the proposed changes is to assure greater consistency in the application of such arrangements to individual contracts.

We believe that the proposed modifications represent, for the most part, an improvement over the existing regulations. However, in our opinion, the proposed rules do not provide adequate guidance on the important concept of contractor investment. The stated policy of the Department of Defense is that contractors should maintain an appropriate level of investment in their contract work-in-process inventories at all times. In this regard, authorities responsible for approving milestone billing arrangements will evaluate each request on its individual merits with this DOD policy in mind. Specifically, the proposed revision provides that:

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"In negotiating milestone billing arrangements contracting officers must seek to establish an overall level of contracting financing which will result in the contractor maintaining an appropriate investment in contract work-in-process inventory. In determining an appropriate level of investment, due consideration should be given to the nature of the program, the value of the contract, and additional financing to be provided through milestone billings. The level of contract financing provided by milestone billings is determined by (i) the number, value and timing of milestone billing events, and (ii) the manner in which milestone payments are liquidated against contract line item deliveries. Proposed milestone billing arrangements should, therefore, be carefully evaluated to ensure that (i) contract financing policy objectives are being met, and (ii) that the proposed milestone billing arrangement will not result in an unreasonably low or negative level of contractor investment in contract work-in-process inventory."

(Although the wording in the policy section of the proposed modification sets forth criteria to be considered in negotiating these arrangements, there is no adequate definition of what is an "appropriate" level of contractor investment in work-in-process inventories. In this regard, the guidance provided is subject to varying interpretations. It is likely that different meanings of "appropriate level" and "unreasonably low" will result even though the circumstances may be similar. We therefore suggest that additional clarifying guidance be contained in regulations to assist contracting officers in making these determinations.)

We have no further comments to offer.

Sincerely yours,

Harry R. Van Cleve
Harry R. Van Cleve
Acting General Counsel