



February 2022

# DEFENSE CONTRACTING

More Insight into Use  
of Financing  
Payments Could  
Benefit DOD in Future  
Emergencies

# GAO Highlights

Highlights of [GAO-22-105007](#), a report to congressional committees

## Why GAO Did This Study

The COVID-19 pandemic had unprecedented effects on the U.S. economy, including the contractors that develop and build weapon systems for DOD. One of the actions DOD took to help ensure the financial health of the defense industrial base was to increase cash flow to contractors and, in turn, their suppliers.

Congress included a provision for GAO to examine DOD's oversight of these increased payments. This report assesses (1) the extent to which DOD made increased progress payments and advance payments from April 2020 through June 2021 and (2) the extent to which DOD has visibility into how those payments flowed to suppliers.

GAO analyzed data on advance and progress payments, reviewed acquisition regulations and policies, and met with officials from responsible DOD offices and representatives from contractors and industry groups.

## What GAO Recommends

GAO recommends that DOD determine what data would be needed to assess defense prime contractors' use of any additional contract financing that could be provided during future national emergencies, including their use of these funds to support their suppliers, and identify steps to collect that data. DOD concurred with the recommendation.

View [GAO-22-105007](#). For more information, contact Timothy J. DiNapoli at (202) 512-4841 or [dinapolit@gao.gov](mailto:dinapolit@gao.gov).

February 2022

## DEFENSE CONTRACTING

### More Insight into Use of Financing Payments Could Benefit DOD in Future Emergencies

## What GAO Found

As defense contractors build weapon systems like aircraft or ships that are both time- and capital-intensive, the Department of Defense (DOD) in certain cases provides contract financing along the way in the form of progress or advance payments. Progress payments can be based on costs incurred by the contractor or the amount of work accomplished. On the other hand, advance payments are funds provided to the contractor before work begins. During the COVID-19 pandemic, DOD took steps to increase the progress payment rates for eligible contracts, from 80 to 90 percent on contracts awarded to large businesses and from 90 to 95 percent on contracts awarded to small businesses. In addition, DOD made some advance payments. As a result, from April 2020 through June 2021, beyond its normal financing activities, it is estimated that DOD provided more than \$6 billion in additional financing to help lessen the economic impact of COVID-19 on the defense industrial base (see table).

**Department of Defense's Use of Progress and Advance Payments to Address COVID-19 Impacts on the Defense Industrial Base, April 2020 through June 2021 (in billions)**

Payment type	Total payments made	Estimated amount of additional payments made to address COVID-19 impacts	Percent made to address COVID-19 impacts
Progress payments	\$55.0	\$5.6	10
Advance payments	\$0.9	\$0.8	89

Source: GAO analysis of Department of Defense data. | GAO-22-105007

DOD set these higher rates to increase cash flow to the defense industrial base during the pandemic. DOD, which does not have privity of contract with subcontractors, has little insight into the extent to which prime contractors provided these additional funds to their suppliers. DOD officials said they generally relied on their typical oversight processes. These processes include the use of standard forms that contractors submit to request additional contract financing. These forms, however, are not designed to and do not provide comprehensive visibility into whether contract financing payments were flowed down to suppliers. Further, while DOD requested information from 28 contractors on the use of these additional funds, the resulting information provided limited insight into the flow of funds to suppliers. The Navy, which is responsible for oversight on shipbuilding contracts, worked with the Defense Contract Audit Agency to review how shipbuilders flowed the COVID-19-related funds to suppliers and found that some paid their suppliers more quickly than usual.

If DOD were to again increase contract financing rates to address cash flow challenges faced in future emergencies, more information on whether prime contractors are providing these funds to their suppliers, would help ensure that the funds were having their intended effect of mitigating impacts on the defense industrial base.

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## Abbreviations

COVID-19	Coronavirus Disease 2019
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
DPC	Defense Pricing and Contracting
FAR	Federal Acquisition Regulation
MOCAS	Mechanization of Contract Administration Services
NAVSEA	Naval Sea Systems Command
SUPSHIP	Supervisor of Shipbuilding, Conversion and Repair

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February 17, 2022

### Congressional Committees

The Department of Defense (DOD) spends hundreds of billions of dollars annually to acquire major weapon systems, such as aircraft, ships, and satellites. DOD has long recognized that the contracts for items like weapon systems are capital intensive and take a long time to produce. DOD annually provides contractors with billions of dollars via contract financing, which includes progress and advance payments, prior to the contractor delivering the final product. In the absence of this financing, contractors would need to borrow from commercial sources or use their own funds to cover the costs of producing these systems.

As the Coronavirus Disease 2019 (COVID-19) pandemic gripped the country in early 2020, concerns arose regarding the health of the economy, including the defense industrial base—the network of thousands of contractors that help develop and manufacture the products DOD buys. Among other steps to help ensure the health of the defense industrial base, DOD increased cash flow to prime contractors through contract financing provided in the form of progress payments, or advance payments when necessary. For example, on March 20, 2020, DOD issued a “class deviation” to raise the customary rate of progress payments from 90 percent for contracts awarded to small businesses to 95 percent, while increasing the customary rate applicable for contracts awarded to other than small businesses (hereinafter referred to as “large businesses”) from 80 percent to 90 percent.<sup>1</sup>

In the conference report accompanying the National Defense Authorization Act for Fiscal Year 2021, the House and Senate conferees expressed their support for DOD’s actions to increase cash flow to the defense industry during the pandemic.<sup>2</sup> However, the conferees also raised questions about whether and how the companies that received those funds increased the rate of payments to their subcontractors and other suppliers. The conference report included a provision for GAO to examine the extent to which DOD established effective oversight

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<sup>1</sup>DOD Class Deviation 2020-O0010 (Mar. 20, 2020); Defense Federal Acquisition Regulation Supplement (DFARS) § 232.501-1.

<sup>2</sup>H.R. Rep. No. 116-617, at 1710-11 (2020) (Conf. Rep.).

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procedures to ensure that the recipients of these funds provided, as appropriate, increased payments to their subcontractors and other suppliers. This report addresses that provision and a provision in the CARES Act for GAO to provide a comprehensive audit and review of federal contracting pursuant to authorities provided in the act.<sup>3</sup>

This report assesses (1) the extent to which DOD made increased progress payments and advance payments from April 2020 through June 2021, and (2) the extent to which DOD has visibility into how those payments flowed to subcontractors and other suppliers.

To determine the amount of increased progress and advance payments DOD awarded from April 2020 through June 2021—when progress payments rates became effective to the most current data available during our review—we analyzed data on progress and advance payments from two sources. These sources were (1) the Defense Finance and Accounting Service’s (DFAS) Mechanization of Contract Administration Services (MOCAS) database and (2) the Navy’s Supervisor of Shipbuilding, Conversion and Repair (SUPSHIP), which administers Navy shipbuilding contracts. DFAS provided data on dollar amounts of progress payments and advance payments paid to large and small businesses, including the estimated amount of funds attributable to the increased rate of progress payments from MOCAS, while SUPSHIP provided similar information from DOD’s Wide Area Workflow database.<sup>4</sup> To determine if the data were reliable, we reviewed how the data are maintained and we interviewed knowledgeable officials on how the data are updated and used, among other steps. We found the data are reliable to report on the dollar amounts paid out in progress and advance payments for the period we reviewed.

To determine the extent to which DOD has visibility into how progress and advance payments flow to subcontractors and other suppliers, we reviewed the Federal Acquisition Regulation (FAR); the Defense Federal Acquisition Regulation Supplement (DFARS); and DOD, Navy, and SUPSHIP policy documents to understand the procedures and processes

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<sup>3</sup>CARES Act, Pub. L. No. 116-136, § 19010 (2020).

<sup>4</sup>MOCAS is an integrated contract administration and payment system. The system is designed to provide the Defense Contract Management Agency and the DFAS with electronic information necessary to accomplish their mission of contract and payment administration. The Wide Area Workflow is a web-based system for electronic invoicing, receipt, and acceptance. It creates an electronic folder to combine the three documents required to pay a vendor—the contract, invoice, and receiving report.

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related to the use and monitoring of these types of contract financing, including whether any changes occurred subsequent to the declaration of the COVID-19 national emergency in March 2020. We met with officials from Defense Pricing and Contracting (DPC), which is responsible for DOD contract policy and price, and cost and financing matters; the Defense Contract Management Agency (DCMA), which administers the vast majority of contracts with progress payment provisions with the notable exception of Navy contracts for shipbuilding; and with SUPSHIP about these changes, how they were implemented, and what information was collected to ensure the funds were used how they were intended. We met with a nongeneralizable sample of representatives from five contractors that received high dollar amounts in progress payments and several industry groups to gain an understanding of what expectations were conveyed by DOD on how the increases in progress payments were to be used during the COVID-19 emergency. We used the *Standards for Internal Control in the Federal Government* to assess the extent to which DOD used quality information to achieve its objectives.<sup>5</sup> For more information on our objectives, scope, and methodology, see appendix I.

We conducted this performance audit from February 2021 to February 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

### Overview of Contract Financing

Contract financing, such as progress payments and advance payments, assists defense contractors in managing expenses such as material, labor, and overhead. Progress payments can be based on costs incurred or on a percentage or stage of completion.

**Progress payments based on cost** are made to contractors as work progresses, based on their cost incurred for work completed, and not more frequently than on a monthly basis.

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<sup>5</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

**Progress payments based on percentage or stage of completion** are commensurate with the work accomplished, which needs to meet the quality standards established under the contract. A percentage from each potential progress payment may be retained—or held back—up to 10 percent.<sup>6</sup> The contracting officer may reduce and further eliminate the retention upon achievement of satisfactory progress. As applied to Navy shipbuilding efforts, a Navy official stated that the retention rate is the inverse of the progress payment rate. For example, if the progress payment amount on a contract is 95 percent, then the Navy will hold back 5 percent. Generally, the amount retained decreases as the work is completed.

**Advance payments** are payments made by the government to a prime contractor before performance starts under one or more contracts.<sup>7</sup> The FAR generally considers the use of advance payments to be the least preferred form of contracting financing for non-commercial purchases and states that advance payments should not be authorized if other types of financing are reasonably available to contractors in adequate amounts.<sup>8</sup>

Table 1 provides information on when progress payments and advance payments are appropriate to use under normal conditions.

**Table 1: Department of Defense (DOD) Contract Financing Payment Types for Non-Commercial Purchases and Selected Conditions for Use**

Type of financing	Selected conditions for use
Progress payments	<ul style="list-style-type: none"> <li>• Progress payments are used on fixed-price contracts and may be suitable for use on undefinitized contract actions</li> <li>• DOD uses these payments to finance a certain percentage of a contractor’s work-in-process on fixed-price contracts through reimbursements of allowable costs incurred.</li> <li>• Individual contracts must be valued at \$3 million or more for large business concerns, and must be over the Simplified Acquisition Threshold (which was increased to \$250,000 in the Federal Acquisition Regulation in 2020) for small business concerns.</li> <li>• Contractor needs to have an adequate cost accounting system.</li> <li>• Payments are made to contractors at their request as work progresses, on a not-more-frequently-than monthly basis.</li> </ul>
Advance payments	<ul style="list-style-type: none"> <li>• Advance payments should not be used when other types of financing are reasonably available to the contractor in adequate amounts.</li> </ul>

<sup>6</sup>FAR § 32.103.

<sup>7</sup>FAR § 32.102(a).

<sup>8</sup>FAR § 32.402(b).



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- Advance payments require extensive administration as they are higher risk to the government than other types of contract financing.
  - Contractor shall submit a cash flow forecast showing estimated disbursements and receipts for the period of contract performance. Advance payments will not exceed contractor's interim cash need based on the analysis of the cash flow forecast, the consideration of reimbursement or other payment cycle and—to the extent possible—the contractor's own working capital.

Source: GAO analysis of the Federal Acquisition Regulation and DOD regulations and policies. | GAO-22-105007

Note: Undefined contract action, which is generally DOD's term for a letter contract, means a written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services. Defense Federal Acquisition Regulation Supplement § 217.7401. For actions that are specific to progress payments, see Federal Acquisition Regulation § 52.232-16(k). See also Defense Federal Acquisition Regulation Supplement § 216.603; Federal Acquisition Regulation § 16.603.

In response to the COVID-19 National Emergency, on March 20, 2020, DOD issued a "class deviation" that raised the rate of customary progress payments from 80 percent to 90 percent on eligible contracts awarded to large businesses, and from 90 percent to 95 percent on contracts awarded to small businesses.<sup>9</sup> These rates had remained unchanged for large businesses since 2001.<sup>10</sup> In addition, on that same day, the Assistant Secretary of the Navy, Research, Development, and Acquisition issued a memorandum directing the reduction of retentions on existing Navy contracts to an absolute minimum. In response, the Naval Sea Systems Command (NAVSEA) reduced its retention rates on shipbuilding contracts to 1 percent.

Several offices and agencies within DOD have a role in managing contract financing, including

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<sup>9</sup>DOD's customary progress payment rates (see DFARS § 232.501-1) were revised on March 20, 2020 by DOD Class Deviation 2020-O0010, and subsequently revised on April 16, 2020 by DOD Class Deviation 2020-O0010, Rev. 1. According to guidance published by DPC, some contracts were not eligible to receive an increased rate for a variety of reasons, such as contracts for which a "stop payment" had been issued and contracts for which an alternate liquidation rate had already been established. For the purposes of our report we define large businesses as anything "other than a small business" as defined by the North American Industry Classification System, which defines businesses based on industry and is the basis of the Small Business Administration's size standards.

<sup>10</sup>In 2001, DOD amended DFARS to increase the customary progress payment rate for large business concerns from 75 to 80 percent. Customary Progress Payment Rate for Large Business Concerns, 66 Fed. Reg. 49864 (Oct. 1, 2001) (codified at 48 C.F.R. pts. 232 and 252). Civilian agencies have also issued class deviations to increase their progress payment rates. For example, the General Service Administration issued a class deviation on April 24, 2020, that raised its progress payments rates to 90 percent for large businesses and 95 percent for small businesses. GSA Class Deviation CD-2020-09 (Apr. 24, 2020).

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- **DPC**—which reports to the Office of the Under Secretary of Defense for Acquisition and Sustainment—is responsible for all pricing, contracting, and procurement policy matters. This office formulates and oversees DOD-wide pricing policies, including the use of progress and advance payments.
  - **DCMA** monitors contractors' performance and management systems to ensure that cost, product, and performance are in compliance with the terms of contracts delegated to them for administration. DCMA generally maintains contract financing payment data for DOD progress payments for contracts DCMA administers. Within DCMA, the Cost and Pricing Center supports DOD-wide analysis of contract data to support DOD-wide decision making, among other things.
  - **SUPSHIP**, which is part of NAVSEA, is the Navy's primary on-site representative at the private shipyards that build Navy ships, and is tasked with overseeing the shipbuilders' production processes. One function SUPSHIP provides is contract administration, which includes processing and overseeing progress payments.
  - **The Defense Contract Audit Agency (DCAA)** provides contract audits and accounting and financial advisory services for DOD. When requested, DCAA will perform pre- or post- payment audits on progress payments.

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## General Process for Administering Progress Payments

For fixed-price contracts or contracts with fixed-price contract line items, the use of progress payments (whether based on incurred cost or percentage or stage of completion) is generally negotiated at the time of contract award. Thereafter, throughout the performance of the contract, the contracting officer, or a representative delegated by the contracting officer, is responsible for reviewing a contractor's request for progress payments, monitoring the contract for satisfactory performance, and approving payment once it is determined that the proper paperwork has been submitted and work performance meets contract requirements. For progress payments based on costs incurred, to determine the amount of payment a contractor will receive, the contractor submits data to the government showing allowable costs the contractor has incurred up to that point. The contracting officer or their designee will check to make sure that the information submitted is complete and the amount requested in progress payments was calculated properly.

For payments based on stage of completion, physical progress on a deliverable, such as the construction of a ship, is used to determine the progress payments to be paid to the contractor. Similar to progress payments on a cost incurred basis, in Navy shipbuilding contracts, for

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example, the contractor submits data to the Navy to receive payment. In general, shipbuilding contractors must show actual physical progress completed—consistent with the percentages negotiated in the contract—in order to be paid a portion of the contract price. The contractor will submit information on both material and labor used, among other things, to show progress completed. The Navy will complete an independent assessment to confirm the submitted information. One way the government can determine how much progress has been made is by using the contractor’s earned value management system.<sup>11</sup>

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### Relationship between Prime Contractors and Subcontractors and Other Suppliers

DOD generally contracts with prime contractors that will in turn subcontract with other contractors or suppliers. A prime contractor can have a variety of payment terms set up with its subcontractors and suppliers. For example, several contractor representatives we interviewed stated payment terms typically range from within 30 to 90 days after the subcontractor delivers an item. In addition, prime contractors can offer progress payments to subcontractors and other suppliers, though some contractor officials stated subcontractors and suppliers they work with tend not to prefer financing mechanisms, such as progress payments, and may prefer payment upon delivery. The government does not have privity of contract with subcontractors and generally does not have insight into terms between prime contractors and their subcontractors and other suppliers, although certain prime contract terms may be flowed down to subcontracts by regulation.

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### Recent GAO Work on DOD Contract Financing Policies

In June 2019, we reported that DOD had not comprehensively assessed how its contract financing policies affect the defense industry in more than 30 years.<sup>12</sup> We noted that since that last assessment was completed, there had been numerous changes in the defense industry, economic and market conditions, legislative and regulatory requirements, and business practices. We concluded that without assessing the collective impact of these changes, DOD may be assuming too much financial risk or providing contractors with levels of working capital that were not commensurate with what is needed to help finance long-term projects and might be affecting its ability to attract new entrants into the defense market. We recommended that DOD conduct a comprehensive

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<sup>11</sup>Earned value management measures the value of work accomplished in a given period and compares it with the planned value of work scheduled for that period and with the actual cost of work accomplished.

<sup>12</sup>GAO, *Contract Financing: DOD Should Comprehensively Assess How Its Policies Affect the Defense Industry*, [GAO-19-406](#) (Washington, D.C.: June 27, 2019).

assessment of the effect that its contract financing and profit policies have on the defense industry and update that assessment on a recurring basis. DOD concurred with the recommendation and has actions underway to start this assessment.

## DOD Provided Billions in Additional Cash Flow during the COVID-19 National Emergency

DOD Provided an Estimated \$5.6 Billion in Additional Progress Payments from April 2020 Through June 2021

According to DFAS and SUPSHIP data, DOD paid out a total of \$55.0 billion in progress payments from April 2020 through June 2021. DFAS and SUPSHIP estimated \$5.6 billion—or about 10 percent of the total amount of progress payments made during this period—was attributable to the COVID-19-related progress payment rate change and reduction in the amount the Navy retained on its shipbuilding contracts. See table 2 for more information on the amount paid out in progress payments.

**Table 2: Progress Payments and Additional Cash Flow from April 2020 through June 2021 (in billions of dollars)**

Cognizant contract administration office	Total amount of progress payments provided	Estimated amount of additional cash flow stemming from COVID-19-related change in payment rates
Defense Contract Management Agency	\$42.9	\$5.4
Navy's Supervisor of Shipbuilding, Conversion and Repair	\$12.2	\$0.3
<b>Total</b>	<b>\$55.0</b>	<b>\$5.6</b>

Source: GAO analysis of Defense Finance and Accounting Service and the Navy's Supervisor of Shipbuilding, Conversion and Repair data. | GAO-22-105007

Note: Dollars may not sum to total due to rounding.

Most of these funds were provided to large businesses. For DCMA administered contracts, approximately \$40.5 billion of the \$42.9 billion in progress payments—or 94 percent—went to large businesses, with the remaining going to small businesses. Similarly, on shipbuilding contracts, nearly all of the \$12.2 billion in progress payments went to large contractors.

## DOD Provided Over \$940 Million in Advance Payments Mostly Due To COVID-19 Related Circumstances

In total, DOD provided \$942.3 million in advance payments to contractors from April 2020 through June 2021. As shown in table 3, the majority of the advance payments during this time frame were COVID-19-related.

**Table 3: Advance Payments Provided by the Department of Defense from April 2020 through June 2021**

(in millions of dollars)

Military Department <sup>a</sup>	Total amount of advance payments made	Amount of COVID-19-related advance payments	Percentage of COVID-19-related advance payments
Air Force	\$593.6	\$490.7	83%
Navy	\$348.7	\$348.7	100%
<b>Total</b>	<b>\$942.3</b>	<b>\$839.4</b>	<b>89%</b>

Source: GAO analysis of Defense Finance and Accounting Service data. | GAO-22-105007

<sup>a</sup>According to the Defense Contract Management Agency, the Army and other defense agencies did not provide any advance payments during this time frame.

Of the \$942.3 million provided in advance payments, about \$708.2 million—or 75 percent of the total amount of advance payments authorized during the time frame—was provided to one contractor that produces components for Air Force and Navy aircraft. According to the Air Force and Navy justifications supporting the use of advance payments, these funds were needed by the contractor because of COVID-19-related circumstances. The rest of the advance payments went to two small businesses, the majority of which were related to COVID-19 circumstances. We discuss DOD’s decision to provide the advance payments and their oversight of the contractor’s use of these payments later in this report.

## DOD Has Limited Visibility into How Funds Flowed to Suppliers

After DOD raised progress payment rates to help increase cash flow to the defense industry it generally relied on its standard oversight processes and ad hoc inquiries to determine the extent to which large defense contractors subsequently provided these funds to their subcontractors and other suppliers. DOD, however, lacked meaningful visibility into the extent to which the increased funds reached all the businesses that would benefit from them. Selected representatives from defense companies and industry associations we interviewed stated that they understood DOD’s intent and flowed the increased progress payment funds down to their suppliers as DOD intended, and sped up payments to subcontractors and other suppliers. However, Navy documentation indicated that the contractor that received the largest portion of advance payments from the government did not provide

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enough details to provide the government with insight into the use of these funds.

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### DOD Intended Increased Cash Flow to the Reach the Defense Industrial Base, Including Subcontractors and Other Suppliers

According to DOD officials, within 30 days of the COVID-19 national emergency declaration, DOD acted to increase progress payment rates and issued over 1,700 contract modifications. DOD officials noted that they were able to modify contracts quickly because it did not impose additional requirements on the contractors that would have required negotiation, such as increased reporting requirements.

DOD's March 2020 class deviation that increased progress payment rates did not explicitly state that prime contractors should flow down the increased rates of payments to their subcontractors and other suppliers. However, DPC officials told us they conveyed the expectation that prime contractors should flow down the funds to subcontractors and other suppliers on multiple occasions through industry associations and in individual communications with the largest prime contractors. Additionally, DPC provided written responses to frequently asked questions surrounding the class deviation and associated rate increases through DPC's webpage. According to one of the responses, the department conferred with major prime contractors to encourage flow down of the increased progress payment rate throughout the supply chain. Further, DPC noted that upon issuance of the class deviation, DOD officials briefed representatives from industry associations on the implementation procedures and conveyed the government's expectations that financing would be flowed down to suppliers. The Navy was more explicit in its March 2020 memorandum that reduced the Navy's retentions, stating that it was increasing cash flow to contractors to help ensure that the Navy's defense industrial base, and in particular the underlying suppliers, remained solvent and available to support the Navy.

Representatives from the defense industry associations and the contractors we interviewed stated that it was clear to them that DOD expected that the increased funds were to be provided, as appropriate, to suppliers and small businesses. DPC, however, did not request that DCMA conduct any additional surveillance or oversight activities to determine if this particular intent of the class deviation was met. As a result, according to DPC and DCMA officials, DCMA continued to manage progress payments according to its normal processes and procedures.

Our discussions with DCMA officials, as well as our review of DCMA's Progress Payment Multifunctional Administration Guidebook, relevant

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FAR and DFARS clauses, and standard progress payment request forms indicate that these processes and procedures do not typically include explicitly requesting or assessing information on the flow down of funds from prime contractors to subcontractors and other suppliers.<sup>13</sup> For example, the process by which contractors submit requests for progress payments and the system DCMA uses for tracking progress payments—MOCAS—does not provide information on whether contractors provided the additional funding to their subcontractors and other suppliers or paid them more quickly. According to DPC officials, the system was not designed to collect this type of information.

Contractor requests for progress payments for costs incurred, submitted via a Standard Form 1443, reflect the amount that subcontractors have billed the prime contractor. While prime contractors receive payment for costs incurred, they are under no legal obligation to pay their subcontractors or suppliers differently than the terms to which the parties have agreed. According to DCMA officials, DCMA generally cannot enforce such contract terms between prime contractors and subcontractors. For example, officials told us that if they were made aware of a prime contractor not paying their subcontractors appropriately, they would encourage the prime contractor to pay in accordance with the terms of the contract, and if allowable by the terms of the contract with the government, DCMA could reduce or suspend future progress payments.

A DCMA administrative contracting officer responsible for overseeing progress payments to a major defense contractor told us that the process for reviewing progress payments is to first ensure the progress payment clause is in the contract and that the contract is eligible for progress payments. Then, this official ensures the contractor is only requesting progress payments on the fixed-price contract line item numbers. In accordance with the progress payment surveillance plan, the official monitors performance of the contract, identifies risk, and records the reviews. In addition, the official ensures that the contractor is not requesting more than what it is eligible to receive. Other DCMA administrative contracting officers told us they follow similar processes, which generally have not changed due to the pandemic's increased rates of progress payments. All administrative contracting officers we contacted

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<sup>13</sup>Department of Defense, Defense Contract Management Agency, *Progress Payment Multifunctional Administration Guidebook*; (Feb. 2021).

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reported that they have limited insight into how a contractor flows down payments to its subcontractors and other suppliers.

In part to determine if increased cash flow reached vulnerable suppliers as DOD intended, in late 2020, DOD requested information from 28 contractors on the impacts of COVID-19 on their businesses, including the use of progress payments and the flow down of funds to subcontractors and other suppliers. However, DOD's efforts resulted in only minimal insight. Twelve of the 28 contractors responded to the data call and the level of information provided varied. For example, seven of the 12 contractors reported some information regarding how much suppliers were paid monthly in additional financing, including progress payments; two reported that they provided payments but did not report how much; and three reported they did not provide the increased rates of progress payments to their suppliers or pay them faster than before the pandemic. DPC officials told us that they had not validated the information the contractors reported, followed up on missing information, or requested additional information. As a result, the information provided allowed minimal insight into the extent to which prime contractors as a whole flowed down funds to their suppliers.

In contrast, SUPSHIP officials worked directly with DCAA to gain insight into how prime contractors flowed funds to subcontractors and other suppliers. DCAA's reviews showed that several shipbuilders made efforts to pay their suppliers as quickly as possible, and that at least one made focused efforts to specifically support small and disadvantaged business suppliers. This information provided SUPSHIP officials with additional insight into the extent to which contractors were supporting the Navy's intent of supporting the larger defense industrial base, including subcontractors and other suppliers. For example:

- One DCAA memorandum noted that from July to September 2020, a shipbuilder expedited approximately \$62 million more in payments to suppliers than the expedited funds it received from the government. In addition, payments were made about 11 days earlier than the due date and 26 days faster than the previous baseline period of January to June 2020.
- Another DCAA memorandum in March 2021 showed that a shipbuilder paid out invoices to its suppliers, on average, 12 days earlier in February 2021 than during the previous baseline period reviewed.



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- Another DCAA report showed that in various periods from March 2020 through March 2021, a different shipbuilder averaged 16 to 23 days to pay its small and disadvantaged business suppliers, in particular, while it did not expedite payments to other vendors.

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### Industry Representatives We Interviewed Indicated Progress Payments Generally Went to Suppliers as DOD Intended

Several company representatives told us that their companies provided the additional funds they received from the increased progress payments to their subcontractors and other suppliers to help stabilize their suppliers' operations. These representatives stated that, in general, they reduced the time it took to pay their subcontractors and other suppliers, and in one company's case, to as few as 5 days. Others provided funds to their subcontractors above those received from the government as increased progress payments. For example:

- A representative from a large contractor reported that the company reduced the number of days it took to pay subcontractors and other suppliers to 5 to 15 days, down from an average of 20 to 25 days before the pandemic, with a priority focus on smaller, more vulnerable businesses. The company reported that it averaged more than \$435 million weekly in faster payments through mid-2021, and paid out more to subcontractors and other suppliers than the amount provided by the government from the increased progress payment rates. According to company officials, this information was reviewed and validated by the contractor's internal audits and reported to DOD. However, DOD officials stated they did not validate the information.
- Representatives from another large contractor said they were no longer tracking how quickly payments were made to suppliers, but told us that they paid out more funds on an accelerated basis than they received from the government from the increased progress payment rates.
- Representatives from a third large contractor said there had not been much difference overall in the speed with which they paid subcontractors and other suppliers, but that they typically average less than 30 days, with some locations paying in around 14 days.

We reviewed publicly available corporate financial data to determine, to the extent possible, how long contractors might be taking, on average, to pay their subcontractors and other suppliers. These data, however, are not specific enough to separate a company's commercial side of business from its defense side of business. It is possible that one entity of the company has faster payments than the other and combining the two sides could skew results. In addition, the data available do not specify when progress payments were used, but rather the total amount of funds used

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to pay a company's debts. As such, it was not possible to determine, using publicly available information, if progress payments flowed to subcontractors and other suppliers faster due to the increased rate of progress payments.

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**DOD Officials Said Contractor Was to Provide Information on the Use of Advance Payments, but Reported Issues with Timeliness and Transparency**

As previously mentioned, one contractor that experienced a significant reduction in its commercial aircraft business due to the pandemic received about \$708.2 million—or nearly 75 percent—of all advance payments made by DOD from April 2020 through June 2021. According to the Navy and Air Force's documentation justifying the advance payments, this contractor generally does not rely on government contract financing, such as progress payments, because the contractor and its suppliers self-finance. Since the contractor's government segment is heavily reliant on cash flow from the commercial sector, it expressed concern regarding the continuing impact of the COVID-19 pandemic on liquidity for itself and its suppliers. In seeking advance payments, the contractor stated that the funds would be used to pay itself and its subcontractors and other suppliers, particularly those at risk. Subsequently, the contractor said it made offers—sometimes multiple offers—of its advance payments to well over 100 suppliers, many of which were U.S. small businesses. According to reports submitted by the contractor, around 30 percent of the suppliers that were offered the advance payments from the contractor accepted.

According to the DCMA administrative contracting officer, the contractor was to provide updates on how the advance payments were spent. Although the contractor did provide information on the advance payments, according to the DCMA official, the information provided did not include enough details to support that the costs incurred were eligible costs.<sup>14</sup>

In April 2021, the Navy notified the contractor that although the contractor complied with the monthly reporting requirement and issued final reports for its contracts, its submissions were missing information and the contractor could be subject to repayment of the funds determined not to be allocable or allowable. However, according to Navy documentation, the Navy decided to not ask for the funds back from the contract because

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<sup>14</sup>According to the terms, eligible costs would include direct labor and materials costs, indirect costs and other business operations, including accelerated payments to subcontractors. GAO did not review and assess the contract, including any terms for required reporting, nor the timeliness and sufficiency of any contractor submissions provided in response to those requirements.

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it determined it would be an inefficient use of time and resources. The Navy used a payment model as the basis for its decision as well as the Navy's reported satisfaction with the contractor's progress and adherence to contract delivery schedules. The Navy documentation stated that ultimately, the contractor would deliver the products for which the advance payments were provided and therefore these funds would have been paid to the contractor anyway. According to the DCMA official, the Air Force did not have an option to attempt to recover the funds due to the way the terms of the advance payment were worded, but notified the contractor that its past performance rating for the contract would reflect the agency's determination of noncompliance with the terms of the advance payments.<sup>15</sup> The contractor submitted additional information to DCMA in September 2021 and asserted that its use of advance payment funds complied with the terms negotiated for the advance payment.

Federal standards for internal control state that management should use quality information to achieve the entity's objectives and as changes in objectives and risks occur, management should change information requirements as needed to meet these modified objectives and address these modified risks.<sup>16</sup> DOD officials said that they intended, in part, that the increased rate of progress payments and the use of advance payments would help provide additional cash flow to the defense industry, including at the subcontractor and supplier level. DPC, however, did not task another oversight organization, such as DCMA or DCAA, to obtain additional information, nor require that contractors provide information on whether they flowed, where appropriate, the additional funds to their subcontractors or suppliers and obtained limited information on an ad hoc basis. Without such information, DOD cannot ensure that its actions were achieving its intended effect.

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## Conclusions

At the outset of the pandemic, DOD took action to shore up the defense industrial base, including increasing the rate of progress payments and providing advance payments, thereby supporting the defense industry with billions of dollars of additional cash flow. While these payments were

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<sup>15</sup>Past performance must be considered in selecting contractors for negotiated competitive procurements expected to exceed the simplified acquisition threshold, unless the contracting officer documents the reason why past performance is not an appropriate evaluation factor for the acquisition. FAR § 15.304(c)(3). For additional information on the use of past performance, please see GAO, *Contractor Performance: Actions Taken to Improve Reporting of Past Performance Information*, [GAO-14-707](#) (Washington, D.C.: Aug. 7, 2014).

<sup>16</sup>[GAO-14-704G](#).

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made to the prime contractors, DOD expected that those contractors would use the funds, in part, to help ensure the financial viability of their subcontractors and other suppliers. DOD's standard oversight processes, however, provided little insight into how these funds were flowed to subcontractors and other suppliers. DOD now has an opportunity to better position itself during any future national emergencies. Identifying what type of data are needed and options for collecting these data could help DOD maximize the impact of using progress and advance payments to help support the industrial base should it decide to follow a similar approach in future national emergencies.

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## Recommendation for Executive Action

The Secretary of Defense should ensure that the Under Secretary of Defense for Acquisition and Sustainment determine what data would be needed to assess defense prime contractors' use of any additional contract financing that could be provided during future national emergencies, including their use of these funds to support their subcontractors and other suppliers, and identify steps to collect that data. (Recommendation 1)

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## Agency Comments

We provided a draft of this report to DOD for review and comment. DOD provided written comments, which are reprinted in appendix II. DOD concurred with our recommendation. DOD also provided technical comments that we incorporated where appropriate.

We are sending copies of this report to the appropriate congressional committees; the Secretary of Defense; the Under Secretary of Defense for Acquisition and Sustainment; the Principal Director, Defense Pricing and Contracting; the Commander, Naval Sea Systems Command; the Supervisor of Ships, Conversion and Repair; and, the Secretaries of the Air Force, Army, and Navy. In addition, the report is available at no charge on the GAO website at <https://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-4841 or [DiNapoliT@gao.gov](mailto:DiNapoliT@gao.gov). Contact points for our

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Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

A handwritten signature in black ink, appearing to read "Timothy J. DiNapoli". The signature is fluid and cursive, with the first name "Timothy" and last name "DiNapoli" clearly legible.

Timothy J. DiNapoli  
Director, Contracting and National Security Acquisitions

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*List of Committees*

The Honorable Jack Reed  
Chairman  
The Honorable James M. Inhofe  
Ranking Member  
Committee on Armed Services  
United States Senate

The Honorable Patrick Leahy  
Chairman  
The Honorable Richard Shelby  
Vice Chairman  
Committee on Appropriations  
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The Honorable Rob Portman  
Ranking Member  
Committee on Homeland Security and Governmental Affairs  
United States Senate

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The Honorable Jon Tester  
Chairman  
The Honorable Richard Shelby  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
United States Senate

The Honorable Adam Smith  
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The Honorable Mike Rogers  
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Committee on Armed Services  
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House of Representatives

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The Honorable Kevin Brady  
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Committee on Ways and Means  
House of Representatives

The Honorable Betty McCollum  
Chair  
The Honorable Ken Calvert  
Ranking Member  
Subcommittee on Defense  
Committee on Appropriations  
House of Representatives



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# Appendix I: Objectives, Scope, and Methodology

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Our objectives in this report were to assess (1) the extent to which the Department of Defense (DOD) made increased progress payments and advance payments from April 2020 through June 2021 and (2) the extent to which DOD has visibility into how those payments flowed to subcontractors and other suppliers.

To determine the amount of increased progress and advance payments DOD awarded from April 2020 through June 2021—when progress payments rates became effective to the most current data available during our review—we analyzed data on progress and advance payments from two sources. These two sources were (1) the Defense Finance and Accounting Service (DFAS) Mechanization of Contract Administration Services system (MOCAS) and (2) the Navy’s Supervisor of Shipbuilding, Conversion and Repair (SUPSHIP), which administers Navy shipbuilding contracts.<sup>1</sup> DFAS provided data on dollar amounts of progress payments and advance payments paid to large and small businesses, including the estimated dollar amount of funds attributable to the increased rate of progress payments from MOCAS, while SUPSHIP provided similar information from DOD’s Wide Area Workflow database. We reviewed progress payment data on definitized contracts only. Defense Pricing and Contracting (DPC) officials stated that undefinitized contract actions were not eligible to receive the increased rate after an update to the class deviation in April 2020.<sup>2</sup> Because undefinitized contract actions effectively could not receive the rate increase during the period covered in our review, we did not include these actions in our review.

To assess the reliability of the data we received from DFAS via MOCAS, we reviewed documentation on what information is maintained within the system, how the data were maintained, the data dictionary for the system, and what data, if any, are required for reporting on Coronavirus Disease

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<sup>1</sup>MOCAS is an integrated contract administration and payment system. The system is designed to provide the Defense Contract Management Agency (DCMA) and the Defense Finance and Accounting Service with electronic information necessary to accomplish their mission of contract and payment administration. The Wide Area Workflow is a web-based system for electronic invoicing, receipt, and acceptance. It creates an electronic folder to combine the three documents required to pay a vendor—the contract, invoice, and receiving report.

<sup>2</sup>See the Defense Federal Acquisition Regulation Supplement (DFARS) subpart 217.74. Undefinitized contract action, which is generally DOD’s term for a letter contract, means a written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services. DFARS § 217.7401. For actions that are specific to progress payments, see FAR § 52.232-16(k). See also DFARS § 216.603; FAR § 16.603.

2019 (COVID-19) related issues. We also interviewed knowledgeable officials on how the data were updated and used. For the Navy data that came from the Wide Area Workflow, we interviewed knowledgeable officials on how the data are maintained and updated. For both systems, we determined the data are reliable to report on the dollar amounts paid out in progress and advance payments.

To determine the extent to which DOD has visibility into how progress and advance payments flow to suppliers, we reviewed the Federal Acquisition Regulation (FAR); the Defense Federal Acquisition Regulation Supplement (DFARS); and DOD, Navy, and SUPSHIP policy documents in order to understand how procedures and processes related to these payments were prior to the COVID-19 emergency. Subsequently, we reviewed policy memoranda and guidance issued by DOD to determine what financing policy changes were made due to the COVID-19 emergency. We interviewed officials from DPC and SUPSHIP about these changes, how they were implemented, and what information was collected on these changes to ensure the funds were used how they were intended. We used the *Standards for Internal Control in the Federal Government* to determine the extent to which DOD used quality information to achieve its objectives.<sup>3</sup>

We interviewed officials from the Defense Contract Management Agency (DCMA), which administers the vast majority of contracts with progress payment provisions—with the notable exception of Navy contracts for shipbuilding—and reviewed documentation to determine DCMA's role and processes with regard to progress and advance payments and to what extent this changed in response to the COVID-19 national emergency. We also collected information from several DCMA officials responsible for progress payment oversight for three large contractors to determine what information DCMA reviewed on progress payments paid to those three contractors. We received information from the Defense Contract Audit Agency (DCAA) about its typical role in progress payments and the role it had for SUPSHIP payment reviews. We also analyzed DCAA memos about shipbuilders' payments to their suppliers.

We met with representatives from one small and four large contractors to discuss how progress payments, and advance payments if applicable,

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<sup>3</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

were used during the COVID-19 emergency.<sup>4</sup> We chose this nongeneralizable sample of contractors because of the large dollar amounts of progress payments they received during our time frame. Additionally, we met with several industry groups including the National Defense Industrial Association, Professional Services Council, Aerospace Industries Association, and the Shipbuilders Council of America to gain an understanding of what expectations were conveyed by DOD on how the increases in progress payments were to be used during the COVID-19 emergency.

Finally, we analyzed documentation on the justification and use of advance payments in the Air Force and the Navy. Additionally, we reviewed a letter issued by the Navy to the contractor on its use of the advance payment funds, DOD memoranda describing the terms and conditions for the use of advance payments, and monthly reports submitted by the contractor. We interviewed knowledgeable officials on how these payments were used and what oversight DOD had on the use of these payments.

We conducted this performance audit from February 2021 to February 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>4</sup>For the purposes of our report we define large businesses as anything “other than a small business” as defined by the North American Industry Classification System, which defines businesses based on industry and is the basis of the Small Business Administration’s size standards.

# Appendix II: Comments from the Department of Defense



ACQUISITION  
AND SUSTAINMENT

## OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

Mr. Timothy J. DiNapoli  
Director, Contracting and National Security Acquisitions  
U.S. Government Accountability Office  
441 G Street, NW  
Washington DC 20548

Dear Mr. DiNapoli:

This is the Department of Defense (DoD) response to Government Accountability Office (GAO) Draft Report, GAO-22-105007, "DEFENSE CONTRACTING: More Insight into Use of Financing Payments Could Benefit DoD in Future Emergencies," dated February 2022 (GAO Code 105007).

As noted in the Conclusions section of this report, the Department took action at the outset of the pandemic to shore up the defense industrial base. Within thirty days of the March 13, 2020, Presidential Proclamation Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak, we published a class deviation increasing the customary progress payment rate for eligible contractors. This action provided much-needed cash flow to prime contractors and their subcontractors/suppliers to help ensure their financial health to support the DoD mission throughout this national emergency.

DoD concurs with GAO's recommendation, as indicated in the enclosure. My point of contact is Ms. Sara Higgins who can be reached at [sara.a.higgins2.civ@mail.mil](mailto:sara.a.higgins2.civ@mail.mil).

Sincerely,

**TENAGLIA** Digitally signed by  
**.JOHN.M.1** TENAGLIA,JOHN.  
**154945926** M.1154945926  
Date: 2022.01.28  
11:56:43 -05'00'

John M. Tenaglia  
Principal Director,  
Defense Pricing and Contracting

Enclosure:  
As stated

Enclosure

**GAO Draft Report Dated February 1, 2022**

GAO-22-105007 (GAO CODE 105007)

**“DEFENSE CONTRACTING: MORE INSIGHT INTO USE OF FINANCING  
PAYMENTS COULD BENEFIT DOD IN FUTURE EMERGENCIES”**

**DEPARTMENT OF DEFENSE COMMENTS  
TO THE GAO RECOMMENDATION**

**RECOMMENDATION 1:** The Secretary of Defense should ensure that the Under Secretary of Defense for Acquisition and Sustainment determine what data would be needed to assess defense prime contractors’ use of any additional contract financing that could be provided during future national emergencies, including their use of these funds to support their subcontractors and other suppliers, and identify steps to collect that data. (Recommendation 1)

**DoD RESPONSE:** Concur. Defense Pricing and Contracting will collaborate with the military departments, the Defense Contract Management Agency, the Defense Finance and Accounting Service, and the Defense Contract Audit Agency to determine what data would be needed to assess prime contractors’ use of any additional contract financing that could be provided during future national emergencies, including their use of these funds to support subcontractors and other suppliers, and identify steps to collect that data.

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

Timothy J. DiNapoli, (202) 512-4841, or [dinapolit@gao.gov](mailto:dinapolit@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Bruce H. Thomas, Assistant Director; Peter W. Anderson, Koffi Dogbevi, Lorraine Ettaro, Scott Hiromoto, Victoria Klepacz, Miranda Riemer, Carrie Rogers, Alyssa Weir, and Robin Wilson made key contributions to this report.

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