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Federal Agencies' Bill Paying Performance and Comments on S. 328, a Bill to Amend the Prompt Payment Act

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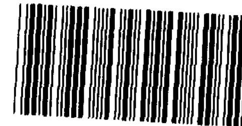
Before the
Committee on Governmental Affairs
U.S. Senate



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Mr. Chairman and Members of the Committee:

We are pleased to be here today to talk about the results presented in our August 1986 report on bill payment progress and to offer our views on S. 328, a bill to amend the Prompt Payment Act, which this Committee was instrumental in passing. We generally agree with the provisions of S. 328 and support the Committee's efforts to strengthen this important legislation. We would like to offer a number of suggested changes--primarily of a technical nature--to the current language of the bill.

We have a long-standing interest in upgrading agencies' payment-timing performance. Our 1978 report[1] and several testimonies on this topic before Senate and House committees contributed to passage of prompt payment legislation in 1982. Also, last summer we testified before the Legislation and National Security Subcommittee of the House Committee on Government Operations and issued a report[2] on how well federal agencies were complying with this law.

Clearly, agencies have achieved some of the improvements sought by the act and the related Office of Management and Budget

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[1] The Federal Government's Bill Payment Performance Is Good But Should Be Better (FGMSD-78-16, February 24, 1978).

[2] Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits (GAO/AFMD-86-69, August 28, 1986).

(OMB) regulations and Department of the Treasury initiatives. Compared with the results presented in our 1978 report, our 1986 report showed that agencies had noticeably reduced the percentage of early and excessively late payments. In fact, reductions in early payments saved the government millions of dollars in annual interest costs. At the same time, fewer excessively late payments no doubt helped to ease some companies' cash flow problems.

However, agencies' performance was still short of that envisioned by the 1982 act. About one-fourth of the commercial payments were still late, and required interest penalties were often not paid. Another fourth was paid early and we estimate that such early payments cost the government about $200 million in interest during a 4-month period. Finally, considering the requirement to pay by due dates and prudent cash management principles which counsel against paying too early, agencies only paid about half of their commercial bills within the period considered as "on time."

Before proceeding further, we should note that OMB and the agencies are taking some corrective actions. Satisfactory completion of those initiatives, including several which are very similar to provisions in S. 328, should help improve payment timing. However, we recognize that mandating certain matters by

law will underscore the urgency to accelerate the management and administrative initiatives required to achieve prompt payment objectives.

Changing the Starting Point for Payment Periods

The proposed bill would modify the criteria for establishing due dates for goods and services acquired under contracts that do not contain payment-timing terms. Like the existing provisions in the Prompt Payment Act, the bill would define the beginning of a payment period as the later of two events: (1) receipt of an invoice or (2) acceptance of goods or services as satisfactory. However, the bill would establish a "conclusive presumption" that, unless the applicable contract states otherwise, acceptance will legally be deemed to occur on the fifth day after the goods are delivered or services are completed. Thus, under certain circumstances, the bill would require using presumed rather than actual acceptance dates for calculating the beginning of a payment period.

We believe that this proposed change is intended to avoid situations in which vendors have satisfactorily carried out their obligations but payment due dates are unreasonably extended because agencies did not accept goods or services in a timely fashion. We agree with the apparent intent of these provisions, but we have some concerns with the present wording of the bill.

First, agencies sometimes accept goods or services on the same day they are delivered or performance is completed. The bill, as currently drafted, could unnecessarily delay payment in instances when actual acceptance of goods or services occurs before the end of the 5-day period. To prevent payment delays in such instances, we suggest that the acceptance date for purposes of calculating payment due dates should be the actual acceptance date, or the fifth day after goods are delivered or services are completed, whichever is earlier.

Our main concern, however, is that using a "conclusive presumption" of acceptance as presented in the bill could be interpreted as preventing agencies from rejecting unsatisfactory merchandise or services if they do not do so within 5 days (or another contractually specified period) after delivery. The section-by-section analysis accompanying the bill does not seem to envision such an effect. We suggest that any amendment along these lines clearly spell out that it applies solely for purposes of establishing due dates and calculating interest penalties and that penalties should not be due if goods and services are rejected sometime after the 5-day period. Effective internal controls over disbursements generally require actual acceptance before payment is made. This sound management practice should continue.

Another provision in the bill would clarify where an invoice must be received in order to start the payment clock. It would establish the invoice receipt date as the day the designated "office or employee of the agency" first received it. We suggest substituting "place or person" for the above phrase to cover those instances when vendors are instructed to send their bills to points outside of an agency.

To illustrate, the Department of Housing and Urban Development (HUD) has designated local real estate companies to manage HUD-owned properties. They arrange for repairs, accept resulting work as satisfactory, and receive invoices for work performed. They then forward the invoices to the appropriate HUD office for final approval and subsequent payment directly to the contractor who performed the work. We found that, in some instances, HUD improperly calculated payment due dates by basing them on when the HUD office had received the invoices from the real estate companies rather than on when the companies had received the invoices from the vendors. Several payment centers in other agencies followed similar practices. Such practices can result in payments that are sufficiently late to require interest penalties, which agencies may not pay.

Our suggested change should help ensure that due dates--and the decision as to whether agencies owe interest penalties--are

based on when invoices are initially received at the designated point.

Finally, some causes of late payments cannot be effectively addressed through legislative changes. For example, incomplete data and delays in forwarding receiving/acceptance reports to payment centers were a major cause of late payments. Without adequate internal controls to ensure that such documents are completed properly and forwarded promptly, the proposed 5-day period may not significantly decrease payment delays. In fact, adopting the 5-day rule could increase the percentage of payments requiring interest penalties. This potential increase emphasizes the importance of our recommendation that agencies forward acceptance documents to appropriate payment centers in the short time frame required by OMB.

Invoices Required for Periodic Payments Under Supply and Service Contracts

Another objective of the bill is to clarify that the provisions of the act apply to various periodic payments authorized under some supply and many service contracts. However, as currently worded, the bill may inadvertently impose additional administrative requirements on vendors and agencies.

Currently, the act does not require vendors to submit invoices for all periodic payments. The proposed bill states that periodic payments for supplies or services are to be conditioned on either acceptance of or certification that goods or services are satisfactory <u>and</u> on receipt of an invoice.

GSA pays for some services--like rents--without requiring vendors to submit invoices at monthly or other intervals. Instead, based on rental agreements, payment systems are programmed to automatically pay set amounts at prescribed intervals through the end of the contract period. This helps ensure timely payments, reduces administrative costs to both the agency and the vendors, and concurrently provides controls over payment amounts and periods. We suggest modifying the bill to avoid requiring invoices in circumstances where they are not necessary to ensure good internal controls over disbursements.

<u>No Invoices Required for Some Food Items</u>

Conversely, in the interest of improving internal controls, we suggest that the Committee consider requiring vendors to submit invoices before being paid for meat items and perishable agricultural products.

The Prompt Payment Act currently calls for calculating payment due dates for such purchases based solely on when the

product is delivered. Applying this criterion, we found that interest penalties were due on some of our sample payments even though vendors had not submitted invoices by the due dates. Agencies have to choose between paying interest penalties or observing good internal controls which, in these instances, would call for receiving an invoice prior to payment. One control feature is to use invoice numbers as part of an automated edit check to prevent duplicate payments.

The proposed bill does not address payments for meat items and perishable agricultural products. We suggest adding invoice receipt dates to the Prompt Payment Act's existing criteria for calculating payment due dates for such products. Thus, the specified payment period would commence either on the date a proper invoice is received at the designated location or on the date the products are delivered, whichever is later.

Late Payment Penalties

The bill would require agencies to pay double interest penalties if they do not automatically pay any penalties due and if a vendor subsequently writes to ask that such penalties be paid. We agree that agencies should pay penalties they owe. Doubling penalties would be a strong incentive to do so. We are not aware of any similar practices the private sector.

We noted that agencies often did not pay required interest penalties. This was more often the result of poor management and administrative controls rather than of any purposeful withholding of penalty payments. Paying closer attention to details such as contract payment-timing terms and other improvements as recommended in our report would increase the percentage of on-time payments as well as help ensure that any required penalties are paid. We believe that the requirement for more detailed reporting of agencies' payment-timing performance--and the promised validation of the information by agency inspectors general--will also be a strong incentive for agencies to pay penalties when due.

Eliminating Grace Periods

The bill would eventually eliminate grace periods--periods during which agencies may pay bills late without incurring interest penalties. While we understand vendors' concern about grace periods, we see merit in keeping some grace periods but perhaps shortening the 15-day period. Completely eliminating grace periods will increase the government's administrative costs for paying commercial bills and result in further delays for some payments.

This applies especially to civil agencies which do not issue their own checks but, instead, send schedules of approved

payments to the Treasury for check issuance on a specific day. Delivery time to the Treasury--mostly by mail--can fluctuate considerably, and Treasury processing time can take somewhat longer than anticipated. Agencies cannot fully compensate for these factors because payment centers (1) attempt to send to the Treasury only one schedule of payments due on a particular day and (2) generally do not finalize and forward such schedules until about 5 days before the due date.

There are valid reasons for the payment centers' actions. In the interest of efficiency, the Treasury wants payment schedules recorded on magnetic tape to include at least 100 payments. Also, Treasury issues all checks for payments listed on a schedule on the same day. Consequently, hundreds of low-volume payment centers generally must consolidate all or most of their invoices due on the same date on one schedule if they want to use an automated payment process. However, documentation needed to ensure that the payments are proper (such as invoices and receiving reports) frequently does not arrive at the payment center until just before the due date. Thus, forwarding schedules earlier than 5 days before the due date would almost certainly require that all, or additional, schedules be prepared manually. This would be less efficient and increase the risk of making duplicate payments because manually processed payments bypass certain critical automated systems checks and edits.

Also, eliminating grace periods could further delay some payments. The Treasury may only issue checks in amounts authorized by an agency. Therefore, if checks could not be issued by due dates, the Treasury would have to return the particular payment schedules to the respective agencies to obtain approval to pay late payment penalties. This would become particularly important if the double interest penalty provision included in this bill became law. However, returning the schedules would delay these payments even further and add additional administrative costs to both the Treasury and the agencies.

Finally, eliminating grace periods may encourage agencies to make payments before they are due in order to avoid incurring interest penalties. Although this would benefit vendors, we estimated in August 1986 that federal interest costs attributable to early payments far exceeded the amount of penalties owed to vendors for late payments.

Although we estimated that agencies made about 15 percent of commercial payments during grace periods, we did not find intentional abuses such as routinely paying as closely as possible to the end of such periods. Instead, most grace-period payments were made within 5 days after the due date. Also, when the Prompt Payment Act was passed in 1982, short delays in payments were not the issue. Instead, contractors and their

representatives pointed out that payments which were delayed for 3 or 4 months or even longer were the problem. An alternative might be to shorten the current 15-day grace period to 10 or perhaps 7 days. This would be more equitable to vendors and would not disrupt agency payment operations.

Discount Periods

Two sections of the bill seem to offer conflicting guidance regarding the start of discount periods. One appears to provide uniform criteria by defining the beginning of discount periods as the date an agency receives an invoice. Another states that agencies may take discounts only in accordance with vendor terms.

Adding due-date criteria for discounts would result in more uniform contract terms. Uniformity, whenever possible, is desirable because we found that varying payment terms were one of the primary causes for improperly taken discounts. However, we believe that the terms as defined in the bill should apply only if the pertinent contract and invoice are silent on the matter. Also, we would prefer the discount starting-date rules already established in the Federal Acquisition Regulation (FAR). These start discount periods after receipt of the invoice or delivery of the goods or services, whichever is later. Such terms seem equitable to vendors because both events are usually under their control. In addition, the FAR terms ensure that agencies have

time to inspect goods or services before the end of the discount period, thus allowing them greater opportunity to take offered price reductions.

Reporting Payment-Timing Performance

The bill expands agency reporting requirements for late payments but does not address two factors which contributed to OMB's overstatement of payment-timing performance.

Some agencies based their performance data on the number of invoices for which they had paid interest penalties. Others reported based on the number of checks issued--checks which often cover numerous invoices. We also noted that some contracts for utilities call for prescribed late payment penalties rather than interest when bills are paid late. Some agencies did not report such penalties because the law and OMB's regulations call only for reporting interest penalties.

To ensure consistent and comprehensive reporting, we suggest that the term "payment" as used in the bill, in reference to reporting requirements, be changed to "invoices." Also, the reporting requirements should be augmented to include both interest penalties and other kinds of late payment charges. OMB agreed with our recommendations in this area and has used the

suggested language when calling for fiscal year 1986 payment-timing information from agencies. Also, OMB is currently in the process of incorporating such language in its prompt-payment-related regulations.

Implementation Through the Federal Acquisition Regulation

The bill would require including solicitation and contract clauses regarding due dates in the FAR for use by contracting officers. This would include authority for varying due-date terms for different products. We strongly agree that the FAR should contain due-date provisions, and we understand that, considering the wide range of goods and services agencies procure, some flexibility in setting due dates is needed. However, we caution that the bill as currently worded may result in a wide variety of payment periods. This increases the risk of errors in determining when payments must be made.

As stated in our August 1986 report, a primary cause of late payments was the lack of simple, uniform payment terms. Our ongoing work in this area appears to reinforce this point. We continue to believe that payment-timing performance can be substantially improved and administrative costs reduced by requiring agencies to use standard clauses, including specified payment periods, in contracts. Different payment criteria may be

appropriate for items that require extensive testing before accepting them as satisfactory. However, optimum assurance that payments will be on time calls for minimizing such exceptions.

On a related matter, the bill would require that progress payments under construction projects be made within 7 days unless prevailing industry practice allows more time. Project diversity, the billions of dollars involved, and the fact that many agencies need up to a week just to process payments create some concerns about establishing such a short payment period. Also, purely from an economic standpoint, even small shifts in payment timing can change federal interest costs by millions annually. It is important that the government receive appropriate compensation--such as adequate consideration in setting prices for earlier payments. Otherwise, overall federal costs will increase.

Reducing Bill Payment Work Load

We continue to work with OMB and other federal agencies to improve the timeliness of vendor payments. A matter not requiring legislation but with potential for savings is reducing the number of bills the government must handle. Statistics we gathered during our 1986 review indicate that about 26 percent of commercial bills agencies receive may be for $100 or less. Considering that agencies annually pay about 30 million invoices,

there could be about 7 million bills with invoice amounts of $100 or less.

To demonstrate this point, one of the GSA transactions we reviewed involved a payment for $998.25. This payment was supported by 64 bills from the same company, due on the same day, with individual invoice amounts ranging from $1.75 to $90. Seventeen of these were for $1.75 each. Processing a bill for payment is very labor intensive and generally requires handling by several individuals regardless of the invoice amount. Therefore, we wrote to the Deputy Director of OMB on January 12, 1987, and suggested that it may be appropriate to explore ways to cut down on the volume of bills that have to be paid.

One technique for reducing the number of invoices an agency must handle is to arrange for summary billing with the vendor when contracting for goods or services which otherwise would result in numerous small bills. Such arrangements could specify monthly or other summary billing intervals. This practice would also reduce vendors' invoice preparation and mailing costs. With fewer invoices to handle, agency payment centers could eliminate some of their bill processing backlogs and payment clerks could better ensure that payments are made in accordance with contractual payment due-date terms.

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In conclusion, Mr. Chairman, while offering some technical suggestions, we support the thrust of S. 328. We have recently provided more detailed comments on S. 328 to the Senate Committee on Small Business which we would like included for the record. We are prepared to continue working with the Congress on this matter. We would be pleased to respond to any questions you and the other committee members may have at this time.