

GAO

Report to the Ranking Minority Member,
Committee on Governmental Affairs,
U.S. Senate

May 1997

FINANCIAL MANAGEMENT

The Prompt Payment Act and DOD Problem Disbursements





United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-275091

May 23, 1997

The Honorable John Glenn
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

Dear Senator Glenn:

This letter is in response to your request that we determine whether the Prompt Payment Act of 1982 contributes significantly to Department of Defense (DOD) problem disbursements. The Prompt Payment Act has been described in DOD testimony as pressuring DOD personnel to pay invoices within 30 days even though the payment may cause a problem disbursement.

Problem disbursements are specific disbursements that have not been properly matched with corresponding obligations. Matching disbursements with obligations is an important control for ensuring that funds are used in accordance with the purpose and other limitations specified by the Congress. Without such matching, there is increased risk that (1) fraudulent or erroneous payments may be made without being detected and (2) cumulative amounts of disbursements may exceed appropriated amounts and other legal limits.

Our work focused on the Defense Finance and Accounting Service (DFAS) Columbus Contract Entitlement Directorate because it disburses more funds than other DOD disbursing offices, handles the most complex contracts, is identified with many of DOD's disbursement problems, and processed over 42 percent of DOD's fiscal year 1996 interest penalty payment dollars.

In addition, as subsequently agreed with your office, this report provides information on two matters raised by DOD officials related to provisions of the Prompt Payment Act that they believe result in higher than justified administrative costs. We limited our work on these matters because they were outside of the original scope of our review.

Results in Brief

DOD did not provide, and we did not find, any empirical evidence to support assertions that the Prompt Payment Act contributes to problem disbursements. Also, a 1995 Defense study, which identified several major

contributing causes to DOD problem disbursements, did not cite either the Prompt Payment Act or DOD policies on making timely payments as a cause.

The Prompt Payment Act does not require federal agencies to pay an invoice by the due date. Rather, it requires the government to pay interest if an invoice is not paid on time. DFAS policy statements and daily operating procedures emphasize timely payment to avoid interest penalties and DFAS management has established a 30-day goal for paying most invoices. While some DFAS personnel told us that these policies create “pressure” to make timely payments, they stated that the policies do not result in payments being made inappropriately. Information provided by the DFAS Columbus Contract Entitlement Directorate shows that it is generally able to make most payments in less than 30 days.

During the course of our review, DOD officials expressed concern regarding provisions of the Prompt Payment Act that they believe result in higher than justified administrative costs. One concern relates to the large number of small interest payments. Under the act, contractors are entitled to interest penalties of \$1 or more. Almost 11,000, about one quarter, of all payments of DFAS Columbus Contract Entitlement Directorate interest penalty payments in fiscal year 1996 were for less than \$5, but these payments accounted for only \$28,701, less than one quarter of 1 percent of total interest paid.

Another concern relates to new DFAS procedures for allocating interest payments to appropriation accounts. DFAS and service officials said that these procedures increase the complexity and, accordingly, the cost of making interest payments. Previously, DFAS Columbus charged all interest costs to its own Defense Business Operations Fund (DBOF) account and recovered the amounts through DFAS billing rates. This, in effect, meant that all DFAS customers, and their respective appropriations, shared in the interest penalty payments, regardless of which invoices were not paid on time. The DOD Comptroller was advised that this DFAS practice did not comply with the Prompt Payment Act requirement that agencies pay interest from the appropriation that funds the program that incurred the interest penalty. To address this compliance issue, DOD recently established a number of separate accounts for the direct allocation of the interest charges by DFAS to the services’ appropriations.

Background

Problem disbursements are specific disbursements that have not been properly matched with corresponding obligations. Audit reports have served to highlight the scope and severity of DOD's problems and have reported that billions of dollars in disbursements could not be promptly or accurately matched with related obligations. DOD has recognized this as a major area of concern and is working hard to reduce current problem disbursements. It has many short-term initiatives and long-term plans to reduce such disbursements.

The Prompt Payment Act of 1982, as amended, provides governmentwide guidelines for establishing due dates on commercial invoices and provides for interest payment on invoices paid late. Prior to passage of the act, we reported that the federal government did not have uniform criteria for establishing due dates for vendor invoices.¹ Many invoices were paid too early or too late, sometimes without regard to contract terms, the effect on vendors' cash flow, or the effect on government interest costs. In 1981, we estimated that contractors were losing at least \$150 million annually because of late payments from the federal government. We also pointed out that the government could save at least \$900 million annually if all early payments were instead paid when due.² The Prompt Payment Act and implementing guidance and regulations issued by the Office of Management and Budget (OMB) and DOD are intended to address such issues.

Except where otherwise specified within contracts, the act provides that agencies should pay within 30 days after the designated office receives the vendor invoice or the government accepts the items ordered as satisfactory, whichever is later. This 30-day payment time frame is consistent with the time frame originally included in the May 1978 Department of the Treasury regulations. OMB Circular A-125, which prescribes implementing policy for the Prompt Payment Act of 1982, as amended, directs federal agencies to pay commercial obligations accurately and on time, and to use sound cash management practices.

In fiscal year 1994, the federal government reported that about \$23.4 million in interest was paid under the Prompt Payment Act. Of that amount, DOD paid about \$13.8 million. In fiscal year 1995, reported federal interest payments increased to about \$37 million, of which DOD paid

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

²Actions to Improve Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars (AFMD-82-1, Oct. 8, 1981).

\$25 million. DOD attributed the increase in interest payments, in part, to additional processing time required by changes in its payments process, such as the 1995 requirement for the prevalidation³ of invoices. In fiscal year 1996, DOD paid \$27.9 million in interest. Four DFAS centers processed nearly all of DOD's fiscal year 1996 interest payments.

- DFAS Columbus—\$13.7 million,
- DFAS Cleveland—\$6.7 million,
- DFAS Indianapolis—\$3.7 million,
- DFAS Denver—\$3.1 million, and
- All others—\$.7 million.

DFAS Columbus is divided into three directorates—Contract Entitlement, Stock Fund, and Financial Services. The Contract Entitlement Directorate, which administers large contracts, paid about 48,000 interest penalties totalling over \$11.9 million, which is 87 percent of the \$13.7 million in interest paid by DFAS Columbus in fiscal year 1996. The Stock Fund Directorate paid over 56,000 interest penalties totaling over \$1 million and the Financial Services Directorate paid over 23,000 interest penalties totalling about \$800,000.

Scope and Methodology

We reviewed the provisions of the Prompt Payment Act of 1982, as amended; OMB Circular A-125, which prescribes policy for executive departments and agencies in paying for goods and services; and DOD's regulations and procedures related to the act's implementation. We interviewed individuals at DFAS headquarters in Arlington, Virginia, and the DFAS payment center in Columbus, Ohio, about the implementation of the act and related guidance. Our interviews included voucher examiners, supervisors, deputy directors and the Director, Contract Entitlement, DFAS Columbus, as well as the Director and staff of the Contract Pay Directorate at DFAS headquarters.

We obtained the DFAS Columbus Contract Entitlement voucher payment procedures and reviewed them for procedures related to prompt payment. We also discussed the DFAS Columbus Contract Entitlement procedures for paying interest penalties with the DFAS Columbus Contract Entitlement Prompt Pay Project Officer and obtained sample payment packages to use as examples of DFAS Columbus practices.

³Prevalidation is the process, required by Public Law 103-335, of matching disbursements to the appropriate obligation in DOD's official accounting records before the disbursement is made. The objective of prevalidation is to prevent problem disbursements.

We obtained data from the DFAS Columbus database containing interest payments made in fiscal year 1996 for the Contract Entitlement Directorate, which administers major DOD contracts and paid \$11.9 million of the \$27.9 million in interest penalties paid by DOD in fiscal year 1996. We stratified the interest payments by dollar amount to determine the significance of small interest payments. We relied upon available records and did not independently verify or audit DOD's reported data. Regarding the issue involving allocating interest payments, we interviewed officials in the Army, Navy, Air Force, Marine Corps, and DFAS.

We performed our work from June 1996 to March 1997 in accordance with generally accepted government auditing standards. DOD provided written comments on a draft of this report. These comments are presented in appendix II.

No Empirical Evidence to Support Assertion That the Prompt Payment Act Contributes to Problem Disbursements

DOD officials did not provide, and we did not find, any empirical information to support the assertion that the Prompt Payment Act contributes to problem disbursements. The act does not mandate that an invoice be paid within a specified time frame. Rather, it establishes guidelines for determining payment due dates, and requires that if payment is not made in a timely manner, the government will pay interest to the contractor.

The act states, in part, that "the head of an agency acquiring property or service..., who does not pay...by the required payment date, shall pay an interest penalty...." Further, the act states that "the required payment date is (A) the date payment is due under the contract ... or (B) 30 days after a proper invoice for the amount due is received if a specific payment date is not established by contract."

In a June 1995 report, DOD identified a number of causes of problem disbursements, but these did not include the Prompt Payment Act. DOD's Acquisition and Financial Management Working Group stated that while quantitative data were unavailable, observations and experience suggested that the root causes of problem disbursements were inaccurate or incomplete data within different information systems, resulting in payments being charged to the wrong lines of accounting.⁴ The group also reported that data entry errors and the lack of timely distribution of contract documents among program managers, contracting and contract

⁴Our report, *Financial Management: Improved Management Needed for DOD Disbursement Process Reforms* (GAO/AIMD-97-45, Mar. 31, 1997) noted that DOD needs more complete analysis to identify the underlying causes of problem disbursements.

administration offices, contractors, disbursing offices, and accounting offices were major contributors to problem disbursements. Other contributing factors reported were a high percentage of manually processed payments, non-uniform contract structure and format, multiple funding sources for a single contract line item, complex progress payment procedures, and the lack of standard automated systems. In our April 1997 report on DOD contract payment practices, we discussed similar issues and recommended that DOD thoroughly evaluate opportunities to reduce the amount of detail accounting at DFAS Columbus and to streamline payment techniques.⁵

DFAS Management Focuses on Specific Payment Time Frames

On February 22, 1996, the DFAS Director notified DFAS personnel that paying all vendor invoices within 30 days was a key project for 1996. DFAS management had established, as a matter of policy, a goal of paying invoices within 30 days. This goal is also specified in DFAS management statements and the DFAS Columbus daily operating procedures.

DFAS Columbus Contract Entitlement personnel we interviewed were very aware of the Director's emphasis on timely payment, and the voucher examiners and supervisors we spoke with said they felt "pressure" from management to pay invoices within 30 days. However, neither the voucher examiners nor the supervisors believed that this pressure would cause payments to be made in a manner that contributed to problem disbursements.

The DFAS Columbus daily operating procedures also stress timely processing and payment of vouchers. DFAS generates a number of daily reports to monitor the timeliness of invoice payments, including the following:

- The "Overage/Projected Overage Invoices On-Hand" report lists all invoices that are past the due date, or very close to the due date, by number of days.
- The "Potential Interest Payment-Alert" lists all unpaid invoices that are past the established due date.
- The "Interest Due Report" lists unpaid invoices which are 16 or more days past the established due date.
- The "Daily Status of Discount Invoices" lists discounts still available.

⁵Contract Management: Fixing DOD's Payment Problems Is Imperative (GAO/NSIAD-97-37, Apr. 10, 1997).

These reports are distributed to the voucher examiners who are required, each day, to note actions taken to resolve each overaged invoice.

DFAS Is Generally Able to Make Payments in Less Than 30 Days

If DFAS Columbus has the information necessary to make a payment—such as a complete contractor invoice showing quantity and price information that matches the information specified in the contract—payments can easily be made in less than 30 days. Of the 883,318 invoices subject to the Prompt Payment Act that were paid by the DFAS Columbus Contract Entitlement Directorate in fiscal year 1996, DFAS data show that 94 percent were paid on time.

Over half of those invoices paid by the Directorate are routinely matched to the DFAS contract database that contains contract information for determining whether sufficient funds exist to pay the invoice. When matched electronically with the database, the invoices go into an “automated pay” status. Such invoices could be paid in only a few days; however, invoices subject to the Prompt Payment Act are normally released for payment no sooner than the 23rd day after receipt of the invoice. This is to ensure that, consistent with regulations regarding good cash management, such as OMB Circular A-125, the government is not paying invoices any earlier than necessary.

Other Prompt Payment Act Issues

During the course of our review, DOD officials raised two concerns related to the provisions of the Prompt Payment Act that they believe result in higher than justified administrative costs. As agreed with your staff, we are including a description of these matters in this report.

Small Interest Payments

The act states that a business concern shall be entitled to any interest penalty of \$1 or more from the government (interest penalties of less than \$1 are not required to be paid). We found that small interest payments made by the DFAS Columbus Contract Entitlement Directorate comprised a large portion of the number of payments made, but accounted for a very small portion of the total interest dollars paid. For example, as shown in appendix I, of the 47,773 contract entitlement interest payments in fiscal year 1996, 10,789, about one quarter of all interest payments, were for \$5 or less, and totaled \$28,701—less than one quarter of 1 percent of total interest payment dollars. Interest payments up to \$25 comprised over

50 percent of all interest payments, but less than 2 percent of total interest dollars paid.

In the two other DFAS Columbus directorates, the proportion of small interest payments was even higher. In the Financial Services Directorate, over 47 percent of the 23,275 interest penalties paid in fiscal year 1996 were between \$1 and \$5, and accounted for about 3.5 percent of the total interest dollars paid. In the Stock Fund Directorate, over 91 percent of the 56,281 interest penalties paid in fiscal year 1996 were between \$1 and \$25, the smallest category on which data were available, and accounted for about 46 percent of total interest dollars paid.

DOD officials said that the current minimum payment of \$1, which was established almost 15 years ago, may need to be increased because the benefits from such small interest payments may not justify the costs of making such small payments. However, to some extent the number of late payments and the resulting interest and administrative costs related to them are the result of DFAS payment processes and practices and how efficiently they are carried out. For example, for each interest penalty payment, current DFAS policies require that the reason for the interest be identified and documented. In one case, a \$1.05 interest payment was supported by nine pages of documentation.

Allocation of Interest Payments

The second concern raised by DOD officials pertains to the allocation of interest payments to appropriation accounts. The Prompt Payment Act specifies that interest penalties are to be paid from the appropriation which administers the program. Until recently, DFAS Columbus paid the interest payments and charged the payments to the DFAS Columbus DBOF account. DFAS Columbus then recovered the amounts of these interest payments, like all other costs, from the military services through DFAS billing rates. Under this process, all DFAS customers shared the interest expense on payments, regardless of which contracts and appropriations the interest related to.

In December 1995, the DOD Comptroller revised the interest payment policy after being advised by the DOD Office of General Counsel that to be consistent with OMB Circular A-125 and the Federal Acquisition Regulations, the policy should be revised so that DFAS will directly charge the DOD component's appropriated funds available to pay for contract administration of the underlying program. The revised DOD policy requires that, "interest penalties incurred under the Prompt Payment Act shall be

charged directly to the account that funds the administration of the program for which the penalty was incurred.” In early fiscal year 1997, each of the military services implemented approaches to comply with the DOD Comptroller’s direction. While their approaches vary in some ways, each involves the establishment of a number of accounts to which DFAS Columbus is to charge the interest penalties. For example, the Navy has established over 50 individual accounts that are to be used as a means for charging interest penalty payments to the correct appropriations. The processes used by DFAS to allocate the interest payments to the accounts are largely manual—DFAS personnel review payment data and manually enter the account and interest amount into the payment system.

The revised processes are also more complex. Rather than processing a single transaction for the entire amount of interest on a single payment, DFAS now determines the interest amounts for each account that funded the goods or services purchased. In one case, an interest payment of \$1.85 was divided among 56 separate accounting lines. DFAS Contract Entitlement Directorate officials estimate that this new process has increased its average 45-minute interest payment processing time by about 10 percent. Officials did not know how much additional processing time was being incurred at accounting stations.

The services are concerned that the new procedures may not be in the interest of efficient government operations. The Army intends to establish a working group to review the prompt payment procedures and to formulate a policy for the Army and DFAS to use in the next fiscal year.

Agency Comments

In written comments on a draft of this report, DOD agreed with the overall conclusion that the Prompt Payment Act does not contribute to problem disbursements. These comments are reprinted in appendix II.

We are sending copies of this report to the Secretary of Defense, the DOD Comptroller, the Director of Defense Finance and Accounting Services, and interested congressional committees. Copies of this report will also be made available to others upon request.

Please contact me at (202) 512-9490 if you or your staff have any questions concerning this letter. The major contributors to this letter were David Childress, John L. Carter, Rose M. Dorlac, and Julie A. Cahalan.

Sincerely yours,

A handwritten signature in black ink, reading "George H. Stalcup". The signature is fluid and cursive, with the first name "George" and last name "Stalcup" clearly legible.

George H. Stalcup
Associate Director, Defense Financial Audits

FY 1996 DFAS Columbus Contract Entitlement Interest Payments

Interest amount	Number of payments with interest	Percent of total payments	Interest paid	Percent of total interest paid
\$1.00-\$5.00	10,789	22.6	\$28,701	0.2
\$5.01-\$10.00	6,227	13.0	45,074	0.4
\$10.01-\$25.00	8,661	18.1	141,932	1.2
\$25.01-\$50.00	6,087	12.7	218,672	1.8
\$50.01-\$100.00	5,170	10.8	366,959	3.1
\$100.01-\$500.00	7,614	15.9	1,711,826	14.4
\$500.01-\$1,000.00	1,527	3.2	1,066,997	9.0
\$1,000.01-\$5,000.00	1,390	2.9	2,935,843	24.6
Over \$5,000.00	308	0.6	5,405,628	45.3
Total	47,773	100.0^a	\$11,921,632	100.0

Note: We did not independently verify or audit this information.

^aDoes not add to 100.0 due to rounding.

Source: DFAS Columbus Contract Entitlement Directorate.

Comments From the Department of Defense

Note: GAO's comment supplementing those in the report text appears at the end of this appendix.



OFFICE OF THE UNDER SECRETARY OF DEFENSE
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APR 25 1997

Mr. Gene L. Dodaro
Assistant Comptroller General
Accounting and Information Management Division
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

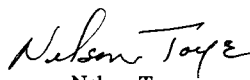
This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report "FINANCIAL MANAGEMENT: The Prompt Payment Act and DoD Problem Disbursements," dated April 4, 1997 (GAO Code 918870/OSD Case 1332).

The Department agrees with the overall conclusion presented in the report that the Prompt Payment Act does not contribute to problem disbursements. Your conclusion confirms the Department's view on this matter.

The report also discusses the minimum interest payment required by the Prompt Payment Act. The current minimum interest payment of \$1 was established almost 15 years ago. Based on the data provided by the Columbus Center of the Defense Finance and Accounting Service, over one-half of the payments made--but less than 2 percent of total interest dollars paid--by its Contract Entitlement Directorate were for interest amounts of \$25 or less. Since it takes an average of 45 minutes to process each interest payment at the Columbus Center, the time spent processing such payments could be better spent on other high priority tasks. Other federal agencies that process large numbers of interest payments also could benefit from an increase in the dollar threshold under which interest payments would not be required.

Thank you for the opportunity to comment on the draft report.

Sincerely,


Nelson Teye
Deputy Chief Financial Officer

See comment 1.

The following is GAO's comment on the Department of Defense's letter dated April 25, 1997.

GAO Comment

1. The Prompt Payment Act of 1982 as amended, which includes the \$1 threshold for interest penalties, was intended to foster equitable payment policies and to encourage federal agencies to improve their payment processes. Any change in the interest penalty threshold could effect all federal agencies as well as the vendor community, and accordingly is a matter for congressional determination. We believe that any initiative to change the minimum interest payment level should consider the efficiency of agency payment processes, the effect of such a change on vendors, and other relevant factors.

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