Recommendation 55: Raise the Prompt Payment Act threshold.

Problem

The costs of complying with the current Prompt Payment Act threshold frequently exceed the payment owed to the vendors. In other words, the government devotes time, money, and administrative capacity to reimburse vendors for negligible dollar amounts.

Background

The Prompt Payment Act (PPA) requires Federal agencies to pay interest on late payments to contractors and vendors for services and property. Under the PPA, the government is required to pay its bills to contractors no earlier than 7 days prior and no later than 30 days after receiving a proper invoice.[1] To make these interest payments on time, DoD must devote money and manpower to processing, administration, and other work.

The PPA's purpose is to mitigate the harm caused to government contractors by late payments for services. The minimum payment threshold is set at $1.00 and has not been adjusted for inflation or interest rate fluctuations since the 1980s.

Early History

In 1981, GAO reported late payments could likely cost contractors at least $150 million per year and possibly as much as $375 million.[2] The paper-based invoicing used at the time heavily contributed to delays in payments, which harmed all parties involved. Vendors suffered because they were forced to borrow from other operating funds to cover immediate costs. DoD and other agencies had to deal with the additional administrative burden of processing late paperwork.

One major issue at the time was the lack of uniform standards for invoice payments to vendors and contractors. Small businesses, with little budget flexibility, suffered most, sometimes even being forced to suspend operations.

Because no uniform procedures for paying invoices on time existed, agencies sometimes paid too early, which cost the government additional money. In the early 1980s, the GAO projected that paying these invoices on time would save the government $900 million per year.[3] The Prompt Payment Act of 1982 provided a remedy for these issues.[4]

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[1] Late Payment Interest Penalties, 5 CFR 1315.10. Also see Contacting Clauses, FAR 32.908 and Prompt Payment, FAR 52.232-25.
[2] GAO, *Actions to Improve Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars, AFMD-82-1,* October 8, 1981, 6, accessed October 30, 2018. https://www.gao.gov/assets/140/135325.pdf.
[3] GAO, *Financial Management: The Prompt Payment Act and DOD Problem Disbursements, GAO/AIMD-97-71,* May 1997, 3, accessed October 30, 2018, https://www.gao.gov/assets/230/224116.pdf.
[4] Prompt Payment Act, Pub. L. No. 97-177, 96 Stat. 85 (1982).

Legislative Background

PPA is codified under 31 U.S.C. Chapter 39.[5] There have been several amendments to PPA, the last of which occurred in 1998.[6] The $1.00 threshold was codified in 1988.[7] Related legislation has been introduced from time to time in subsequent years.[8] The codified section on interest payments reads in part as follows:

> *The interest shall be computed at the rate of interest established by the Secretary of the Treasury, and published in the Federal Register, for interest payments under section 7109(a)(1) and (b) of title 41, which is in effect at the time the agency accrues the obligation to pay a late payment interest penalty.*[9]

OMB regulations implementing PPA set out detailed requirements for calculating interest due on late payments.[10] Vendors that meet all other criteria for receiving interest penalties "shall be entitled to an additional penalty payment when the vendor is owed a late payment interest penalty by an agency of $1.00 or more."[11]

In 2012, OMB issued a memorandum directing executive agencies to "assist in expediting contractor payments to small business subcontractors" by paying their prime contractors "as soon as practicable, with a goal of paying all prime contractors within 15 days of receiving proper documentation."[12] The policy affected only payments in exchange for goods and services, and explicitly exempted PPA's provisions on late-payment interest penalties. The policy was rescinded in mid-2017.[13]

Payment Process

Interest payments begin to accrue 30 days after the government receives a contractor invoice unless a contract includes other specifications. Interest due on a late payment cannot exceed the amount accumulated in 1 year. Interest payments are applicable to procurement contracts, vendor payments, and utilities.[14]

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[5] Prompt Payment, 31 U.S.C. §§ 3901–3907.
[6] Pub. L. No. 100-496 (*Prompt Payment Act Amendments of 1988*) modified several portions of the PPA and added a section on construction contracts. Pub. L. No. 105-362 (*Federal Reports Elimination Act of 1998*) eliminated the requirement that agencies submit annual interest payment reports to OMB.
[7] Codified under 31 U.S.C. § 3902(c)(1). Also see Prompt Payments Act Amendments of 1988, Pub. L. No. 100-496, 102 Stat. 2455 (1988).
[8] For examples in the 115th Congress, see S. 2983 (*a bill to provide for prompt payments to small business contractors*) or H.R. 5337 (*Accelerated Payments for Small Businesses Act of 2018*), both of which would make it mandatory for agencies to pay invoices on small business contracts in 15 days instead of 30.
[9] Interest Penalties, 31 U.S.C. § 3902(a).
[10] Late Payment Interest Penalties, 5 CFR 1315.10. Additional Penalties, 5 CFR 1315.11.
[11] Vendor Entitlements, 5 CFR 1315.11(a).
[12] OMB Memorandum 12-16, *Providing Prompt Payment to Small Business Subcontractors,* July 11, 2012, accessed June 22, 2018, https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2012/m-12-16.pdf.
[13] OMB Memorandum 17-26, *Reducing Burden for Federal Agencies by Rescinding and Modifying OMB Memoranda,* June 15, 2017, accessed June 22, 2018, https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2017/M-17-26.pdf.
[14] DoD Financial Management Regulation, Volume 10, Chapter 7, Section 070201.

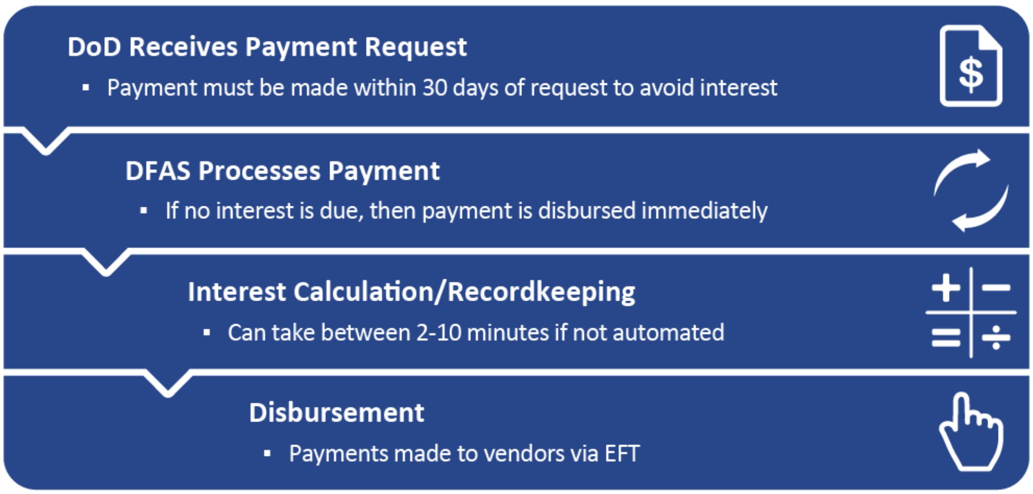
Interest payments are paid out of program funds related to the contract to which the penalty is being applied. It is possible, however, for DoD to use funds from the larger military department associated with the program to cover interest expenses.[15]

Discussion

The administrative workflow for PPA interest payments is shown in Figure 4-15 below.

Administrative Process

Figure 4-15. DoD Invoice Processing Workflow



Contractors and DoD have standardized procedures for payment processing. When a contractor needs payment, an invoice is sent to the Defense Finance and Accounting Service (DFAS) through an online service called Invoicing, Receipt, Acceptance and Property Transfer (iRAPT).[16]

When DFAS receives an invoice from a contractor it is inputted into an entitlement system. As an example, one such entitlement system is the Mechanization of Contract Administration Service (MOCAS). MOCAS automatically determines the invoice due date in accordance with the contract in question.[17]

Should DFAS process a payment after its due date, MOCAS automatically generates a report which is sent to the Prompt Payment Interest Branch. Here DFAS personnel review each invoice case-by-case to determine if interest is due. Applicable interest rates for payments can be obtained from the

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[15] Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, Pub. L. No. 107–117, § 8084, 115 Stat. 2266 (2002). The legislative change in this recommendation would make this provision a part of U.S. Code.

[16] "iRAPT – Invoicing, Receipt, Acceptance and Property Transfer (formerly Wide Area Work Flow)," Defense Finance and Accounting Service, accessed June 22, 2018, https://www.dfas.mil/contractorsvendors/irapt.html.

[17] DoD Inspector General, *Financial Management: Report on DoD Compliance with the Prompt Payment Act on Payments to Contractors (D-2006-076),* April 19, 2006, 1, accessed October 30, 2018, https://media.defense.gov/2006/Apr/19/2001712515/-1/-1/1/06-076.pdf.

Department of Treasury's Financial Management Service Prompt Payment Help Line or from the organization's website. Interest rates are updated biannually, at the end of June and December.[18]

Contracts with interest payments are entered into the Prompt Payment Database. This system then makes payments to contractors. Completed interest payment vouchers are available via Electronic Document Access (EDA).

Depending on which entitlement system is being used, DFAS has automated processes to calculate interest in some cases. If the process is not automated, then each interest calculation can take approximately 10 minutes to process.[19]

Problems with Compliance

PPA has created a regulatory headache for agencies over time. Several GAO and IG reports have confirmed issues with accurate reporting, including within DoD. A 2012 GAO report indicated $54 billion funds subject to PPA were not being considered or reported.[20]

Proliferation of accounting and resource management systems is part of the issue. At the time of the 2012 report, DoD had 19 different entitlement systems associated with commercial payments subject to PPA. Nine of these Enterprise Resource Planning systems were run by components of DoD that are not part of DFAS. GAO found that these nine systems were not considering their funds in the context of PPA legislation.[21] In FY 2011, DoD paid approximately $19 million in PPA penalties. By ignoring the commercial payments made by the nine non-DFAS systems identified by GAO, DoD underpaid vendors nearly $2 million in penalties.[22]

After these findings, GAO recommended DoD and DFAS set up a more comprehensive system to identify all commercial payments subject to the PPA. Although DoD made changes in response to the GAO report, this episode illustrates the complexity of making payments from DoD to vendors. With this issue in mind, emphasis should be placed on eliminating non-value-added actions.

Value Added Breakdown

Congress passed PPA in 1982 at a time when invoice processing was paper based. This system was often backlogged and inefficient. Automation has increased payment rates with the adoption of systems such as iRAPT.[23]

Late payments of less than $1.00 are not subject to PPA. The interest rate has fluctuated over the last 3 decades, yet this threshold has remained constant, with no regard to inflation or changes to the government's invoice paying process.

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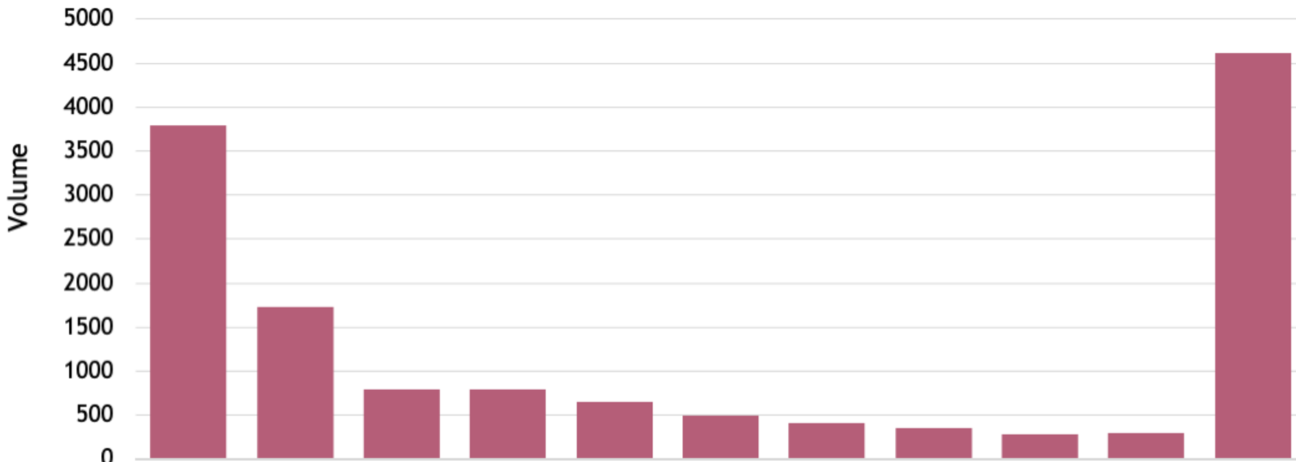
[18] "Prompt Pay Interest Rate History," U.S. Department of the Treasury, Bureau of the Fiscal Service, accessed on October 30, 2018, https://www.fiscal.treasury.gov/fsservices/gov/pmt/promptPayment/rates.htm.
[19] DFAS employee, discussions with Section 809 Panel staff, June-July 2018.
[20] GAO, *DOD Financial Management: Improvements Needed in Prompt Payment Monitoring and Reporting, GAO-12-662R,* June 26, 2012, 3, accessed October 30, 2018, https://www.gao.gov/assets/600/591902.pdf.
[21] Ibid, 3–4.
[22] Ibid, 5.
[23] DFAS employee, discussions with Section 809 Panel staff, June-July 2018.

Figure 4-16. Volume of MOCAS Interest Payments to Businesses in FY 2017[24]



	$0-$10	$10-$20	$20-$30	$30-$40	$40-$50	$50-$60	$60-$70	$70-$80	$80-$90	$90-$100	$100+
Transactions	3788	1731	798	798	645	488	410	351	280	289	4617

Of the 14,195 PPA transactions in FY 2017 within MOCAS, nearly 34 percent were for amounts less than $15. This lack of adjustment has led to an increase in penalties for small dollar amounts. By raising the penalty threshold to $15, these transactions would disappear. This change would only reduce payments to vendors by less than $30,000, or less than 1 percent of total interest payments made out of MOCAS in FY 2017.[25]

Macroeconomic Context

In the decades since PPA enactment, the U.S. dollar has experienced cumulative inflation of about 160 percent.[26] For the PPA threshold amount to have the same purchasing power equivalent to its original $1.00, it would have to be set to about $2.60. In addition to dollar inflation over time, the opportunity costs of delayed payment have declined since PPA enactment. In the early 1980s, U.S. interest rates were at historic highs for the post-WWII era. In mid-1982 when the PPA was enacted, returns on short-term U.S. Treasury securities exceeded 13 percent. As of mid-2018, the equivalent rate was less than 2 percent, meaning that late payments cost companies much less than when the PPA threshold was first established.[27]

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[24] MOCAS data provided by DFAS.
[25] Ibid.
[26] Based on Urban Consumer Price Index (CPI-U) from May 1982 to May 2018, from Bureau of Labor Statistics, accessed July 5, 2018, https://www.bls.gov/data/inflation_calculator.htm.
[27] "Data Download Program: H.15 Selected Interest Rates," Board of Governors of the Federal Reserve System, accessed July 5, 2018, https://www.federalreserve.gov/datadownload/Download.aspx?rel=H15&series=d7e27b7b09a3a7feae95b9c61781fcd8&filetype=csv&label=include&layout=seriescolumn&from=05/01/1982&to=05/31/2018. Analysis based on monthly market yield on U.S. Treasury securities at 3-month constant maturity, quoted on investment basis. Rates of return are rounded from 13.08 percent in June 1982 and 1.90 percent in May 2018.

Transaction Costs

Table 4-5. Transaction Costs for DFAS and Industry (FY 2017 Estimated)[28]

	Low-End Estimate	Medium Estimate	High-End Estimate
DFAS employees working on PPA payments[29]	4	4	4
Annual Salary[30]	$ 47,485	$ 60,000	$ 80,000
Indirect Cost[31]	0%	50%	75%
Total Annual Cost	$ 189,940	$ 360,000	$ 560,000
FY 2017 PPA Transactions[32]	14,195	14,195	14,195
Total DFAS Cost Per Transaction (Estimated)[33]	**$ 13.83**	**$ 25.36**	**$ 39.45**
Contractor Transaction Processing Expense			
Annual Salary Accounts Receivable Analyst (Estimated)[34]	$ 60,000	$ 80,000	$ 80,000
Hourly Rate (Estimated)[35]	$ 28.85	$ 38.46	$ 38.46
Indirect Cost (Estimated)[36]	0%	50%	75%
Adjusted Hourly Rate (Estimated)[37]	$ 28.85	$ 57.69	$ 67.31
Time to Process (Hours)[38]	0.20	0.50	1.00
Total Contractor Cost Per Transaction	**$ 5.77**	**$ 28.85**	**$ 67.31**
Combined DoD/Contractor Cost Per Transaction	**$ 19.60**	**$ 54.21**	**$ 106.76**

PPA costs both contractors and DoD time and money. DFAS employs four full-time staff whose sole job is to process MOCAS PPA-related payments. An industry estimate of employee salaries and related costs indicated each PPA transaction costs the government approximately $14 and costs industry approximately $6.[39] In FY 2017, approximately 40 percent of PPA interest payments were for less than

[28] Data provided by DFAS and the Aerospace Industries Association. DFAS data only covers payments made through MOCAS.
[29] Based on emails with DFAS employees. Only includes those working on MOCAS PPA data on a full-time basis, as of mid-2018.
[30] Low cost estimates assume that DFAS salaries are GS-7 pay grades; higher cost estimates assume higher pay grades.
[31] This line item assumes overhead costs in DFAS including the costs of running IT systems and the partial salaries of additional employees who may periodically work on PPA issues. The low cost estimate assumes no money is spent on this.
[32] FY 2017 figures provided by DFAS employees.
[33] Based on total annual estimated cost to government divided by total number of reported transactions.
[34] Provided via consultation with industry analyst of PPA and other financial issues.
[35] Accountant Salary divided by work year of 2,080 hours.
[36] Estimate of industry's overhead costs involved in processes transactions. Assumed to be zero for low-cost estimate.
[37] Hourly Rate adjusted for indirect cost.
[38] Based on estimates of number of minutes needed to process a payment, provided by industry expert.
[39] Cost estimates based on work performed by Aerospace Industries Association, with underlying assumptions verified by DFAS staff.

$20 in MOCAS alone.[40] Representatives from industry and DoD have expressed agreement that small-value PPA payments are unnecessary.[41]

Conclusions

PPA should be amended to increase its out-of-date payment threshold. Raising the threshold for late payments would save the government time and money without substantially harming contractors.

In 1982 invoicing was slow and paper based. With advances in technology, there is much less reason that the government will be late paying its bills. The administrative process involved with PPA is a burden on DFAS and DoD. There is little value added to processing small payments for vendors because the transaction costs are high. With small changes to the U.S. Code, Congress can make these changes to the benefit of the government and the vendors on which it relies.

Implementation

Legislative Branch

- Amend 31 U.S.C. § 3902(c)(1) to change the $1 threshold for late interest payments to $15.

Executive Branch

- Amend 5 CFR 1315.10 and 5 CFR 1315.11 in accordance with legislative changes to the late interest payment threshold.
- Modify business processes for DFAS and DoD to accommodate the threshold change.

Implications for Other Agencies

- The increased dollar threshold would apply to all other agencies subject to 31 U.S.C. § 3902.

[40] Calculation based on analysis of 14,195 MOCAS transactions in FY 2017 (information provided by DFAS). 8,679 of these transactions (38.9%) were below $20.
[41] Representatives from Aerospace Industry Association and DFAS, interviews with Section 809 Panel, May 2018.