

Paying Small Business Subcontractors More Quickly

Written by Nick Sanders
Monday, 16 July 2012 00:00

The best companies focus on managing cash flow. They work hard on making sure they generate accurate and “adequate” invoices to their government paying office. They work hard on making sure that the cognizant Contracting Officer has updated the payment system to have funds available to pay the invoices. They work hard to stretch out payment terms to subcontractors and suppliers. The goal is simple: get the money in the door (from customers) before the money goes out the door (to suppliers). To the extent they are successful in accomplishing that goal, the need to borrow money (and to pay unallowable interest on loans) is minimized.

We hope you are one of those companies who focuses on cash flow. But if you are one of those companies, then you need to be aware of a recent Memo from the Office of Management and Budget (OMB) that impacts your cash management activities.

On July 11, 2012, the OMB issued [a Memo](#) entitled, “Providing Prompt Payment to Small Business Subcontractors.” The July 11 Memo followed-up on a similar September 14, 2011 Memo, that established as policy the objective that, “to the full extent permitted by law, agencies shall make their payments to small business contractors as soon as practicable, with the goal of making payments within 15 days of receipt of relevant documents.” (“Relevant documents” include a proper invoice and receiving documents indicating acceptances of goods/services.)

The July 11 Memo addresses paying Prime Contractors more quickly, so as to enable them to pay their small business subcontractors more quickly. The Memo states, “agencies should, to the full extent permitted by law, temporarily accelerate payments to all prime contractors, in order to allow them to provide prompt payments to small business subcontractors.”

The “temporary” goal established by the Memo is 15 days. In other words, Executive Branch agencies should pay their Prime Contractors within 15 days, so that the Primes can pay their small business subcontractors within 15 days.

That’s the good news.

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The Memo also directs agencies to “encourage” Prime Contractors to—

... consider modifying their existing contracts with small business subcontractors without consideration or fees to include a clause providing that the prime contractor will pay the small business subcontractor along an accelerated timetable to the maximum extent practicable; and insert a similar clause in their future contracts with small businesses subcontractors.

The foregoing would mean significant work on the part of the Primes. It might also impact the “accepted” way that cash flow has been managed for many years. In particular, it puts in peril the disreputable “pay when paid” contract term that leads to subcontractors financing the Prime Contractors’ cash flow.

The OMB Memo also requests that the FAR Councils create a new contract clause to be inserted into future contracts, so that the accelerated subcontractor payments will be required by regulation (and contract), and Prime Contractors will have more than “encouragement” in order to make accelerated payments.

Naturally, some Prime Contractors will game this. They will accept the accelerated payments from their customers but delay payments to their subcontractors. That’s probably not going to lead to happy past performance ratings.

The OMB had this to say about their appeal to the honor of the Primes—

The acceleration of payments to all prime contractors is a one year, temporary, transitional policy that provides for immediate assistance to small businesses, while affording agencies and prime contractors time to insert contract clauses as described above, or take other appropriate steps, to ensure that prime contractors provide prompt payment to their small business subcontractors. On a date one year after the date of this memorandum, the policy of automatically accelerating all payments to prime contractors shall terminate. ... OMB will then provide further guidance on the appropriate steps that agencies should consider to ensure that small business subcontractors continue to be paid promptly by their prime contractors. Such steps may include continuing to provide accelerated payment to prime contractors that have inserted contract clauses as described above, exercising flexibility that is being considered as part of the implementing regulations of the Small Business Jobs Act that enables agency contracting officers to consider a prime contractor's commitment to paying small business subcontractors in a prompt manner as part of a contract award determination, or other measures as OMB deems appropriate.

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If you read the foregoing paragraph, you will see at least one carrot and at least one stick. We think you ought to consider what you will do over the next year with the accelerated payments you will be receiving. The wrong step might lead to problems.

One more thing we noticed in the OMB Memo.

The term "subcontractor" is difficult to define. Or, rather, it has *many* definitions sprinkled throughout the FAR, the DFARS, and the various solicitation provisions and contract clauses. For purposes of complying with the Memo, the OMB has defined "subcontractor" as the term is used in FAR Part 3.5. *i.e.*, a subcontractor "(1) means any person, other than the prime contractor, who offers to furnish or furnishes any supplies, materials, equipment, or services of any kind under a prime contract or a subcontract entered into in connection with such prime contract; and (2) includes any person who offers to furnish or furnishes general supplies to the prime contractor or a higher tier subcontractor."

So by "small business subcontractor," the OMB means *any* supplier or vendor your business may use. Remember that definition when you contemplate how your company is going to comply with this new emphasis on paying small business subcontractors faster.