

The SB Subcontractor Payment Rollercoaster

Written by Nick Sanders
Thursday, 28 February 2013 00:00



In July, 2012, we [told](#) our readers about an OMB Memo that directed Federal agencies to pay their prime contractors more quickly, so that the primes could, in turn, pay their small business subcontractors more quickly. The Memo established a “one year, temporary, transitional” policy goal of paying the primes within 15 days of receipt of an invoice, so that the primes could pay their small business subcontractors within 15 days. The agencies were directed to “encourage” their prime contractors to modify their existing subcontracts with small business “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 Memo also requested that the FAR Councils create a new contract clause that would require prime contractors to implement that policy, thus moving the policy from a matter of “encouragement” to a matter of regulatory compliance.

We opined at the time that the OMB Memo—

... 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.

Indeed, the FAR Councils heard OMB’s request, and opened FAR Case 2012-031 to make the appropriate regulatory changes. The public comment period ended February 19, 2013. Currently, the public comments are being consolidated by the FAR Secretariat.

[Subsequently](#), we told our readers in August, 2012, that the Defense Procurement and

The SB Subcontractor Payment Rollercoaster

Written by Nick Sanders

Thursday, 28 February 2013 00:00

Acquisition Policy (DPAP) Directorate had decided to jumpstart the matter by issuing a Class Deviation that included a new, mandatory flow-down, contract clause (52.232-99) that required—

Upon receipt of accelerated payments from the Government, the contractor is required to make accelerated payments to small business subcontractors to the maximum extent practicable after receipt of a proper invoice and all proper documentation from the small business subcontractor.

And there things have stood.

Until this week.

The thing that changed was that DOD ended its practice of providing accelerated payments to its prime contractors, about six months early. It documented its policy about-face in [this DFARS Notice](#)

. According to the Notice, DOD now plans a “phased implementation” of the policy (whatever that means). The Notice also reminded us that “This action does not affect DoD's policy to assist small business prime contractors by paying them as quickly as possible after receipt of an invoice and all proper documentation, while also maintaining necessary DoD internal controls.”

Why did the DOD do a 180 degree turn on this matter?

Well, according to [an article](#) at the Federal Times,

Pentagon officials said changing these payment processes combined with other initiatives will add about \$1 billion, or a few days [*sic*] worth, of available cash within working capital spending accounts. ... The Pentagon is facing a \$46 billion reduction to its 2013 budget between March and September should across-the-board defense spending cuts, known as sequestration, go into effect. Also complicating matters is that DoD is operating under a continuing resolution, which freezes spending at 2012 budget levels, creating an \$11 billion shortfall from planned 2013 spending. The continuing resolution also keeps funds aligned in the same accounts as 2012, meaning new programs cannot start and ones that have been terminated are still receiving money. ... The working capital fund pays for business-like activities, such as fuel, spare parts and office supplies. By law, the DoD must keep money in these coffers at all times;

The SB Subcontractor Payment Rollercoaster

Written by Nick Sanders

Thursday, 28 February 2013 00:00

however, the amount of funds in these accounts is shrinking.

The Federal Times article reports that one of the causes of DOD's shrinking working capital is the accelerated payments to its contractors—which we suppose is another example of the effect of unintended consequences.

Note: we are not saying that we don't understand the drivers behind DOD's policy change. We do. We just find the change to be both ironic and amusing.

Meanwhile, those prime contractors that heeded DOD's "encouragement" and modified their subcontracts with small businesses are now stuck with the accelerated payment terms. Those prime contractors that modified their procurement systems to make the accelerated payment terms a part of their standard set of subcontract terms and conditions are stuck with the language.

Of course, it is certainly possible for the primes to do their own 180 degree turns, but reversing the previous changes will cost money and take time, and will take resources away from other matters. At a time when contractors are being driven to do more with less, this is (in our view) a great example of how government decisions impact contractors' overheads ... and why the Defense Department enjoys such a well-deserved reputation for driving up the costs of its goods and services.