



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

January 8, 2003

DPAP/P

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
(ATTN: DEPUTY CHIEF FINANCIAL OFFICER)

SUBJECT: Early Payment Discounts

I am writing to convey my concern that the Department is missing opportunities to receive early payment discounts because of the way we apply discounts on contracts that provide financing payments. Discounts are not taken at the time financing payments are made. Instead, our current practice is to take the early payment discount when items are delivered, and when doing so, apply the discount against the gross amount of the invoice. Thus, we are taking what is intended to be an *early* payment discount against the amount of financing payments long after those payments were actually paid to the contractor.

Contractors are motivated to offer early payment discounts in order to improve their cash flow, but our practice of taking a discount against previously made financing payments does nothing to improve cash flow. The contractor's cash flow is improved only by the net amount of the invoice. For example, assume a contractor's gross invoice of \$1 million reflects liquidation of a financing payment of \$750,000 and a net payment of \$250,000. If discount terms are 1%/10, net 30, under current practice, the DoD applies a discount of \$10,000, i.e., 1% of the entire \$1 million, even though the contractor is actually being paid only \$250,000. So it costs the contractor \$10,000 to be paid \$250,000 twenty days early! Applying discounts in this manner effectively discourages contractors that understand the financial impact our practice from offering them to begin with.

In addition, under DoD's weighted guidelines profit policy, the prices of contracts with financing payments are reduced, via lower profit, to reflect the Government's provision of financing. So a contractor that offers a discount on these contracts has in a sense already "paid" for the financing once, through a lower price, and then must pay for it yet again due to the method that DoD applies when taking a discount.

Our practice for applying discounts is Sound in the Department of Defense Financial Management Regulation (FMR) (chapter 2, paragraph 020105). It is based upon reasoning that, since the contractor has received financing payments within the discount period (and since the financing payments are made prior to delivery of the item or service), the Government is entitled to take a discount on that portion of the delivery

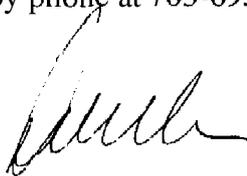


payment that liquidates the financing payments, regardless of whether or not the delivery payment is made within the discount period. And if the delivery payment is indeed made within the discount period, the discount can be taken on both the amount of financing payments being liquidated and the balance (or net cash value) of the payment (i.e., the gross amount of the invoice).

I am fully aware that our latitude to apply discounts in this manner is supported by ASBCA and Comptroller General decisions, but I nevertheless believe it is self-defeating to do so. We would all be better served, i.e., the Department through lower prices, and contractors through better cash flow, if we applied early payment discounts in a more reasonable fashion. In the example noted above, a more reasonable practice would be to apply the discount against the \$250,000 net payment amount that is actually being paid early to the contractor. While the Department would receive a smaller discount of \$2,500, it is better than being offered no discount at **all**.

Accordingly, request your support to change our current practice of taking early payment discounts. I have attached a draft Defense Federal Regulation Supplement change that would revise contractual coverage pertaining to discounts in DoD contracts. Before going forward, I would like your commitment to change the FMR to reflect this revised discounting practice.

My point of contact for this subject is Mr. Richard Brown. He can be reached by e-mail at Richard.G.BrownOosd.mil or by phone at 703-695-7197.



Deidre A. Lee
Director, Defense Procurement
and Acquisition Policy

Attachment:
As stated

J232.111-- Contract Clauses for Non-Commercial Purchases.

(c) The contracting officer shall insert the following clause, appropriately modified with respect to payment due dates in accordance with agency regulations:

(I) The clause at 252.232-8, Discounts for Prompt Payment in lieu of 52.232-8, Discounts for Prompt Payment, in solicitations and contracts when a fixed-price supply contract or fixed-price service contract is contemplated.]

[252.232-8 -- Discounts for Prompt Payment.

As prescribed in **232.111(c)(1)**, insert the following clause:

Discounts for Prompt Payment

(a) Discounts for prompt payment **will** not be considered in the evaluation of offers. However, any offered discount will form a part of the award, and will be taken if payment is made within the discount period indicated in the offer by the **offeror**. As an alternative to offering a discount for prompt payment in conjunction with the offer, offerors awarded contracts may include discounts for prompt payment on individual invoices.

(b) In connection with any discount offered for prompt payment, time shall be computed from the date of the invoice. If the Contractor has not placed a date on the invoice, the due date shall be calculated from the date the designated billing office receives a proper invoice, provided the agency annotates such invoice with the date of receipt at the time of receipt. For the purpose of computing the discount earned, payment **shall be** considered to have been made on the date that appears on the payment check or, for an electronic funds transfer, the specified payment date. When the **discount date falls on a Saturday, Sunday, or** legal holiday when Federal Government offices are closed and Government business is not expected to be conducted, payment may be made on the following business day. The **applicable** discount shall be **computed based on the net cash value of the invoice excluding** recoupment **of** progress payments or performance based payments.]

(End of **Clause**)