CONTRACT FINANCING

Factors That Influence the Use of Financing Methods and DOD's Progress on Proposed Actions

Why GAO Did This Study

In fiscal years 2022 and 2023, DOD provided over $100 billion in contract financing to contractors to acquire weapon systems and satellites, among other products. In April 2023, DOD completed a study on the effect of its contract financing and profit policies on the defense industry. This study was in response to a June 2019 GAO report, which noted that DOD had last assessed its contract financing policies in 1985. The 2023 study resulted in several proposed actions for DOD.

A Joint Explanatory Statement included a provision for GAO to review the results of DOD's Contract Finance Study. This report describes (1) how contracting officers decide to use progress or performance-based payments and the extent to which DOD used these payments from fiscal years 2013 to 2023; and (2) the extent to which DOD implemented the proposed actions of its study.

GAO reviewed the Federal Acquisition Regulation, the Defense Federal Acquisition Regulation Supplement, and DOD guidance to understand when and how progress and performance-based payments can be used. GAO also reviewed fiscal years 2013 to 2023 data on DOD's use of these payments and DOD's April 2023 Contract Finance report; and interviewed DOD contract policy officials and contracting officers from the Army, Navy, Air Force and Defense Logistics Agency. GAO selected contracting officers based on the type of contract financing used in high value contracts. GAO also interviewed industry representatives to obtain their views on the DOD finance report.

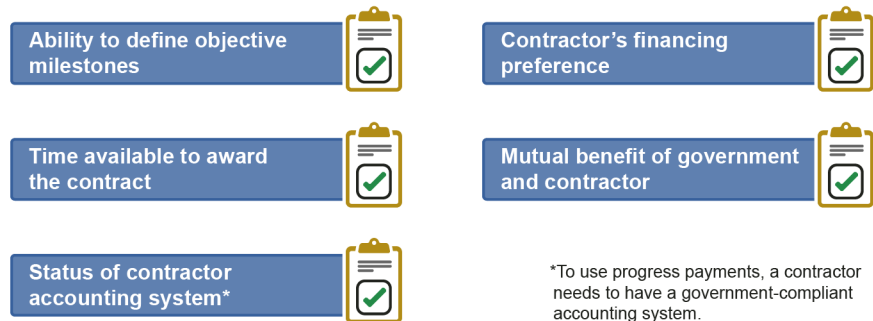View GAO-24-106850. For more information, contact Mona Sehgal at (202) 512-4841 or SehgalM@gao.gov.

What GAO Found

The Department of Defense (DOD) has long recognized that weapon systems—such as aircraft, missiles, and satellites—are capital intensive and take a long time to produce. One way DOD helps contractors manage these expenses is through contract financing.

One form of financing is progress payments, which are paid to contractors as a percentage of costs incurred by the contractor. Another form is performance-based payments, which are made to contractors upon completion of milestones, such as the delivery of a part.

In the last decade, DOD provided more progress payments than performance-based payments to contractors. In fiscal year 2023, DOD provided approximately $28 billion in progress payments and $22 billion in performance-based payments. Contracting officers stated that they consider several factors when deciding between progress or performance-based payments, as shown below.

Factors Department of Defense (DOD) Contracting Officers Consider When Deciding on the Use of Progress or Performance-Based Payments

Ability to define objective milestones	Contractor's financing preference
Time available to award the contract	Mutual benefit of government and contractor
Status of contractor accounting system*	

*To use progress payments, a contractor needs to have a government-compliant accounting system.

Source: GAO interviews with selected DOD contracting officers. | GAO-24-106850

Based on its April 2023 Contract Finance study, DOD proposed 16 actions it could take to help expand the defense industrial base. As of January 2024, DOD had taken steps toward implementing the majority of the proposed actions. DOD estimates that most of these actions will take 1 to 3 years to complete because they are proposed to be regulatory changes. Several of these proposed actions are intended to help subcontractors and small businesses, and include:

- Improving the ability of subcontractors to contact the contracting officer when they do not receive payments from prime contractors, and
- Modifying various regulations, as needed, to improve timely payments to subcontractors, including small businesses.

One near-term proposed action is the use of a model to help educate contracting officers on the importance of cash-flow to contractors. The goal of the model is to help contracting officers negotiate a better deal for the government compared to a contractor's proposal. DOD plans to introduce the new cash-flow model sometime in 2024.

United States Government Accountability Office