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Prompt Payments: Developments and Best Practice

This briefing paper provides an overview of recent key developments regarding prompt payments and considers international best practice in this area.

1 Introduction

This paper is intended to contribute to the Committee for Finance and Personnel's (CFP) on-going consideration to the area of prompt payment of invoices in public contracts. CFP most recently considered this issue in an evidence session with Officials from the Department of Finance and Personnel (DFP) on the 16 January 2013. Primarily, CFP remains concerned that good performance by NI Civil Service departments, in paying invoices within the 10 day best practice target and within the statutory 30 day target, is not reciprocated by main contractors to sub-contractors.[1]

This paper discusses prompt payments and includes: an update of measures introduced by DFP to monitor and improve the payment conditions for subcontractors; information on the statutory and, where possible, the non-statutory measures employed by other jurisdictions and countries; the provisions of new EU proposals in this area; and, some issues for consideration.

2 Prompt Payment of Invoices

This section discusses prompt payments and best practice measures in Northern Ireland in a comparative context.

2.1. Legislative Framework

The existing UK legislation, the *Late Payment of Commercial Debts (Interest) Act 1998* (the *1998 Act*) and the *Late Payment of Commercial Debts Regulations* 2002 (the *2002 Regulations*), applies to Northern Ireland and Wales. The *1998 Act* and subsequent *2002 Regulations* stipulate that, where terms have not been agreed, businesses can claim interest and compensation where payment periods exceed 30 days. In addition, a new EU directive *2011/7/EU on combating late payment in commercial transactions* is due to be implemented by Member States in March 2013. Although the directive will strengthen the existing EU legislation, the effect on UK legislation is marginal due to strong existing provisions.[2]

CFP has considered this issue on a number of occasions. The most recent was an evidence session with DFP and Account NI Officials in January 2013. The Officials highlighted the various measures employed by DFP to date. An Official added the following caveat:[3]

[1] Official Report for the Committee for Finance and Personnel, 16th January 2013, http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Committee-Minutes-of-Evidence/Session-2012-2013/January-2013/Prompt-Payment-and-Construction-Contracts--DFP-Briefing/

[2] See NIAR 779-12, "Prompt Payment of Invoices and new EU Directive", http://www.niassembly.gov.uk/Documents/RaISe/Publications/2012/finance_personnel/1/17812.pdf for more context and detail around the EU and UK legislative framework that underpins current prompt payments legislation and the subsequent best practice measures introduced by the Minister for Finance and Personnel.

[3] Ibid

There is also an onus on subcontractors to come forward with the information. If there are practices such as that, they should be letting us know and forwarding the information to us.

Despite the improvement in performance of NI Civil Service (NICS) departments in meeting 10 day and 30 day targets, CFP remains concerned about the effectiveness of measures introduced by DFP to tackle adverse payment conditions for sub-contractors in public contracts.[4] Primarily, the concern centres on a perceived disincentive for sub-contractors to come forward with information about adverse conditions because of a fear of losing future work and the expense of arbitration.[5]

2.2 DFP measures to date

In January 2012, the Minister for Finance and Personnel issued a statement outlining a number of measures to address malpractice in public contracts. Some of these measures included:

- Centres of Procurement Expertise (COPE) have introduced a requirement for contractors to report on payments to sub-contractors at monthly meetings and periodic checks on payment by the project manager.
- Central Procurement Directorate (CPD) has introduced a requirement for the contractor to submit each sub-contract for acceptance. In addition, CDP may seek assurances from sub-contractors that their prices are reflected accurately in the overall tender.
- Contract terms, including the payment to sub-contractors, will be subject to acceptance by the relevant Department.
- CPD has introduced other measures, through guidance notes, to ensure fair payment conditions. Some measures include: the issuing of Certificates of Unsatisfactory Performance, which excludes contractors from public contracts for one year; the Fair Payment Charter, which is a non-binding agreement included in all public construction contracts; information on potential monitoring methods, including using payment to subcontractors as a Key Performance Indicator (KPI); and, the use of Project Bank Accounts.[6]

2.3 Comparisons with other jurisdictions

[4] For 2012 statistics, see http://www.accountni.dfpni.gov.uk/nics_prompt_payment_table_2012-2013_-_december_2012_update.pdf

[5] CFP Evidence session, see note 1

[6] See CPD website for guidance notes, http://www.dfpni.gov.uk/index/procurement-2/cpd/cpd-policy-and-legislation/content_-_cpd_-_policy_-_procurement_guidance_notes.htm . In particular, see *Procurement Guidance Note 06/12 - Helping SMEs Benefit from Subcontracting Opportunities*, *Procurement Guidance Note 02/12 - Public Procurement: A Guide for Small and Medium Sized Enterprises (SMEs)* and *Procurement Guidance Note 01/12 - Contract Management - Procedures and Principles*

This section identifies relevant statutory and non-statutory measures employed by other jurisdictions in this area. The comparison includes: UK Whitehall Departments; Scotland; Wales; the Republic of Ireland; New Zealand; and, the United States.

UK – best practice in Whitehall Departments

As mentioned previously, the existing UK legislation includes the *1998 Act* and the *2002 Regulations,* which stipulate that where terms have not been agreed, payment periods should not exceed 30 days without incurring interest and compensation penalties. In 2008, the UK Government announced that it would seek to pay invoices within 10 days wherever possible. This was subsequently updated in 2010 with an announcement that the UK Government Departments would seek to pay 80% of valid invoices within 5 days.[7] Budget 2010 also announced a commitment for all UK Government Departments to "explore the option of moving to immediate payment in time, through electronic invoicing for all suppliers."[8]

In addition, the UK Government employs a number of other best practice measures. From 2011, it has been a condition of public contracts in goods and services that main contractors down to tier two subcontractors must be paid within 30 days.[9] Any companies experiencing problems with payment in government contracts, either directly or through the supply chain, can use the Cabinet Office Mystery Shopper Scheme to make an anonymous complaint and trigger an investigation by the Cabinet Office. In the construction and facilities management sectors, the Government is rolling out the use of Project Bank Accounts: legally ring-fenced and protected bank accounts for government contracts from which payments are made directly and simultaneously to all participating members of the supply chain.[10] Firms also are encouraged to become signatories of the Prompt Payment Code (PPC). It is estimated that around 60% of the current UK Government supply chain are signatories.[11]

Issues for Consideration:

1. What would be the pros and cons of DFP implementing a "mystery shopper scheme" or some form of whistleblowing service? Would such a scheme reduce the pressure on sub-contractors to report poor payment practices?

2. Given the EU Commission Work Programme initiative on e-invoicing, what would the pros and cons for DFP to move towards immediate payment through e-invoicing? What would the pros and cons of making such an initiative mandatory throughout all tiers of public contracts?

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[7] HM Treasury, *Prompt Payment: Performance Measures for 2010-2011,* http://www.hm-treasury.gov.uk/d/frab_102_04.pdf
[8] Ibid
[9] Tier two subcontractors refers to contractors in third level of the supply chain i.e. Main contractors, subcontractor, tier two subcontractor.
[10] Department of Business, Innovation and Skills, http://news.bis.gov.uk/Press-Releases/Prompt-payment-for-UK-firms-across-Europe-6804f.aspx
[11] Ibid

3. What would the pros and cons of DFP implementing a new 5 day prompt payment target in line with Whitehall Government Departments?

Scotland

Procurement is a devolved matter in Scotland, but initially Scotland adhered to the *1998 Act*. However, by virtue of section 53 of the *Scotland Act 1998* the powers of the Secretary of State have been conferred to Scottish Ministers. As a result, the *Late Payment of Commercial Debts (Scotland) Regulations 2002,* designed to transpose EU Directive 2000/35/EC, is substantively similar to the *2002 Regulations*.

In 2009, the Scottish Government issued a policy note indicating that a new clause was to be included in all public contracts. It states that valid invoices must be paid within 30 days of receipt of a valid invoice "**at all stages of the supply chain relating to the contract."** The policy note also highlights the requirement to nominate a contact point to whom issues with late payment should be referred. In addition, the note stipulates that contractors are obliged to ensure that a similar clause is included in any sub-contracts.[12]

Furthermore, similar to Northern Ireland, Scotland operates a best practice target of 10 working days from receipt of invoice by government. Section 5 of the Scottish Procurement Directorate's *Expenditure and Payments* in the *Scottish Public Finance Manual* indicates that all payments should be made promptly and, where appropriate, within 10 days in accordance with the Scottish Government target.[13]

Issue for consideration: What would be the pros and cons of including prompt payment as a mandatory condition or clause in government contracts, throughout all stages of the supply chain as in Scotland and Wales? To what extent is such a condition or clause already included in government contracts?

Wales

The *1998 Act* and *2002 Regulations* extend to Wales. In its procurement policy, the Welsh government states that it is committed to paying all undisputed invoices within 30 days of receipt.[14]

A guidance note issued by Value Wales, a division of the Welsh government, states that prompt payment clauses should be included within all contracts and that

[12] Scottish Procurement Directorate, *SPNN 08/2009: Scottish Procurement Policy Note – Payment of Invoices in Public Contract Supply Chains within 30 days,* http://www.scotland.gov.uk/Resource/Doc/1265/0088877.pdf

[13] See *Scottish Public Finance Manual, Expenditure and Payments*, http://www.scotland.gov.uk/Topics/Government/Finance/spfm/procure

[14] Welsh Procurement Policy, http://wales.gov.uk/topics/improvingservices/bettervfm/wob/wagpolicy/?lang=en

adherence to such clauses could be used as a Key Performance Indicator (KPI) and discussed at performance review meetings.[15]

Republic of Ireland

As a Member State, the Republic of Ireland is also bound by the prevailing EU Directives in this area. The transposing legislative framework includes the *Prompt Payment of Accounts Act 1997* and the *European Communities (Late Payment in Commercial Transactions Regulations 2002, SI 388/2002)*, which implement EU *Directive 2000/35/EC*.

Since 2009, central government departments in the Republic of Ireland have been aiming to pay valid invoices within 15 days. Furthermore, as a commitment under the 'EU/IMF Programme of Support for Ireland', the 15-day target was extended to other government agencies, thereby including all public sector bodies.[16]

New Zealand

The New Zealand Ministry of Economic Development (MED) has developed a set of standard conditions of contract for routine government purchases. These conditions are called Government Model Contracts (GMCs). As a result, a number of "user guides" are available which articulate these standards. The most relevant include: *A Suppliers Quick Guide: Invoicing and Payment* and *Quick Guide: Prompt Payment*. Shown below in Figure 1, is a section from the latter, which indicates a number of best practice measures and corresponding expectations.[17]From the information currently available, it is unclear whether there are any mechanisms (statutory or non-statutory) for ensuring compliance with these measures. The guidance does suggest that there is an expectation that a valid invoice, if submitted by the 3rd of the month, should be paid by the 20th of the month.[18]

Fig. 1: *A Suppliers Quick Guide: Invoicing and Payment* and *Quick Guide: Prompt Payment*

[15] ValueWales, http://wales.gov.uk/docs/dpsp/publications/valuewales/121010frameworkagreementguidance.pd f , p. 18

[16] Small Business Unit, Department of Jobs, Enterprise and Innovation, http://www.djei.ie/enterprise/smes/consultation_document_on_late_payments_directive.pdf

[17] Ministry for Economic Development, *Quick Guide: Prompt Payment,* http://www.business.govt.nz/procurement/pdf-library/agencies/gmcs/gmcs-2nd-edition/Quick%20Guide%20-%20Prompt%20Payment%20-Published%20Oct%20%202011.pdf , p. 1

[18] Ibid p. 2

Best practice	Expectation
Agree reasonable payment terms	• Ensure contractual payment terms are fair and reasonable to the supplier and are designed to provide regular cash flow
Give clear guidance to suppliers	• Make it simple and easy for suppliers to get paid • Where you have unusual invoice requirements provide guidance to suppliers • Provide guidance on how to submit an invoice • Where possible, allow invoices to be received by email
Enable prompt payment	• Ensure payment procedures are well organised, timesaving and sufficiently resourced • Ensure staff are trained in payment procedures • Ensure staff prioritise the approval and payment of invoices • Ensure immediate attention to disputed invoices – don't leave it to the day of payment to raise a query with the supplier • Ensure there are proper processes for dealing with any issues that arise • Proactively resolve disputed invoices to minimise any delay in payment • To promote prompt payment set internal payment targets, for example: *90% undisputed invoices paid within 10 days of receipt* • Monitor and regularly report on average payment times • Take action where payment times do not meet contract terms or targets
Pay suppliers on time	• As a minimum, ensure invoices are paid in accordance with contract terms and conditions • Wherever possible, enable early payment
Encourage good practice	• Ensure prime contractors include reasonable payment terms in their sub-contracts • Encourage prime contractors to adopt prompt payment procedures

United States

Late payment legislation includes *The Prompt Payment Act 1999* (PPA), which was enacted on a federal basis, in the United States. The *Prompt Payment Act* (PPA) was enacted to ensure the federal government makes timely payments. Bills are to be paid within 30 days after receipt and acceptance of material and/or services - or - after receipt of a proper invoice, whichever is later. When payments are made untimely, interest should be automatically paid.

The basic requirements of the PPA include requirements for government finance offices to:[19]

- make payments no earlier than 23 days and no later than 30 days from the invoice date;
- pay interest automatically when payment is late; and,
- report performance based on statistical sampling to the Office of Management and Budget.

[19] Credit Research Foundation, *Collecting from the Federal Government,* http://www.crfonline.org/orc/cro/cro-6.html

More specific terms of the PPA include:

- 30 day payment for most items, except;
- 7 day payment terms for meat and poultry;
- 10 day terms for dairy products, edible fats and perishables;
- 14 day terms for construction contracts; and,
- 15 days for "fast pay" terms.

2.3 Proposals for a new EU Directive on Public Procurement

Proposals were issued in 2011 for new EU directives in the area of public procurement, replacing *2004/17/EC* and *2004/18/EC*. The proposals have provisions concerning payment of subcontractors. Articles 71 and 81 of proposals state:[20]

> *In the procurement documents, the contracting entity may ask, or may be required by a Member State to ask, the tenderer to indicate in its tender any share of the contract it may intend to subcontract to third parties and any proposed subcontractors.* (Already catered for in PCR 2006)
>
> *Member States may provide that, at the request of the subcontractor and where the nature of the contract so allows, the contracting entity shall transfer due payments directly to the subcontractor for services, supplies or works provided to the main contractor. In such case, Member States shall put in place appropriate mechanisms permitting the main contractor to object to undue payments. The arrangements concerning that mode of payment shall be set out in the procurement documents.*

According to the EU Commission website, the proposals were to be adopted at the end of 2012 for implementation by Member States by June 2014. However, at the time of writing, the proposals are yet to be adopted.[21] Therefore, the potential effect on the current UK legislation, which applies in Northern Ireland, remains unclear.

Issue for Consideration: Whether DFP submitted a response to the UK government on these proposals; whether DFP views the proposals (in particular paying subcontractors directly) as a positive development; and, whether DFP could envisage wide implementation of this measure across public contracts in NI?

[20] See Article 71, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0896:FIN:EN:PDF and Article 81, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0895:FIN:EN:PDF

[21] Details on the progress of this legislation can be found here: http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2011/0438(COD)&l=en

2.4 Conclusions and Issues for Consideration

In conclusion, it appears that the measures put in place in NI to ensure that good payment practice is reciprocated further down the supply chain compare favourably with the other jurisdictions mentioned in this paper.

However, some difficulties remain in certain areas. For example, despite the various measures introduced by DFP through CPD over the course of 2012, CFP has noted the continued difficulty in persuading subcontractors to report payment malpractice for fear of repercussions.