



Northern Ireland  
Assembly

Committee for Finance and Personnel

# OFFICIAL REPORT (Hansard)

Prompt Payment and Construction  
Contracts: DFP Briefing

16 January 2013

# NORTHERN IRELAND ASSEMBLY

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Prompt Payment and Construction Contracts: DFP Briefing

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**Members present for all or part of the proceedings:**

Mr Daithí McKay (Chairperson)  
Mr Dominic Bradley (Deputy Chairperson)  
Mrs Judith Cochrane  
Mr Leslie Cree  
Ms Megan Fearon  
Mr Paul Girvan  
Mr John McCallister  
Mr David McIlveen  
Mr Mitchel McLaughlin  
Mr Peter Weir

**Witnesses:**

Mr David Carson	Department of Finance and Personnel
Ms Fiona Hamill	Department of Finance and Personnel

**The Chairperson:** I refer members to the papers in their packs, which include the Department of Finance and Personnel (DFP) background paper; a response to issues raised in the Committee's interest paper; prompt payment statistics from October to December 2012; an extract from the general report from the Comptroller and Auditor General (C&AG); and a departmental press release on the introduction of project bank accounts. Furthermore, in the tabled papers, there is correspondence from the Quarry Products Association. I spoke to Gordon Best at an event in the Long Gallery yesterday, and he agreed to send some information that will be quite useful to the Committee.

I welcome Fiona Hamill and David Carson from the Department. Do you want to make a quick opening statement before we go to questions?

**Ms Fiona Hamill (Department of Finance and Personnel):** Certainly. Over the past couple of years, the Committee has shown an awful lot of interest in the issue of prompt payment. As you will be aware, it is something that the Minister supports very strongly.

For those payments that we process ourselves centrally through the Account NI system, we have, in the current economic situation, been very focused on trying to get the number of payments made within 10 days to as high a level as possible. The most recent figures that I have, for the quarter ending December 2012, are that, of the 52,500 payments processed in that quarter, 91% were paid within the 10 days. That is a good balance. The majority of the remaining payments were paid within the normal 30 days.

I have also read through the Committee's research paper on the Department for Business, Innovation and Skills (BIS) consultation on the introduction of the new EU directive and the responses to that. As the Committee is aware, our approach from a Northern Ireland perspective to that consultation was, rather than seek a local response and then provide a single response to BIS, that we seek to get the maximum voice from Northern Ireland. As such, we promoted the consultation with all the relevant interest groups and ensured that they were on the BIS consultee list and had the opportunity to respond directly themselves so as to maximise the voice that we got. BIS is working through the responses to that consultation now. Looking at BIS's initial analysis, we can see that there is relatively little change coming from the new directive, apart from the fact that there was a very firm rejection of any suggestion that there will be an extension of the payment terms for those bits of government providing more commercial-type services — for example, in the health service — to allow them to have longer payment terms of 60 days. That was very firmly rejected, and the statutory payment terms for the public sector will remain at 30 days, with no exceptions. We are awaiting the final response.

**The Chairperson:** The Minister made the announcement early this month in regard to the introduction of project bank accounts. I have been speaking to some people in the sector, and many voices have welcomed the move, but the questions that have been emerging include to what extent it will be rolled out, to what extent it has been rolled out already, and why there are certain limits in terms of the £1 million. The trustees were also referred to, and the fact that some subcontractors will be made trustees of the account. How far down the chain does that go?

**Ms Hamill:** David is the policy lead in that area.

**Mr David Carson (Department of Finance and Personnel):** The announcements on project bank accounts are the latest in a range of measures designed to facilitate payments to subcontractors within the construction industry. We have been looking at that area for quite some time now, but the position has been exacerbated as a result of the economic downturn, which has placed a lot of stress on the industry and has put more pressure on capital flows. The Minister made an announcement to the effect that project bank accounts would be introduced with effect from 1 January, with procurements being taken forward by the Central Procurement Directorate (CPD) from 1 January this year. We will be talking to other centres of procurement expertise (COPEs) about the further roll-out of that across the public sector.

**The Chairperson:** Is there any particular timetable for the COPEs starting to adopt that?

**Mr Carson:** We are talking to them now. In fact, the latest conversation was yesterday. Some people have expressed a particular interest in it. It will depend on the projects that are coming forward. One key criterion for the project to be considered for project bank accounts is the level of subcontractor involvement in that project. We will look to apply it where there is a major element going out to subcontractors.

**The Chairperson:** How will you define "major element"?

**Mr Carson:** It will be where it is significant. There is no cast-iron definition, but it will be where there is a significant element. Perhaps, in some contracts, the electrical element might be significant, or it might be the mechanical element. In other contracts, the structural engineering aspect might comprise a significant element. In percentage terms, where it is 10% or 20%, the application of the project bank account methodology would be beneficial for those subcontractors.

**The Chairperson:** You are saying that, whereas there are no cast-iron figures, if, for instance, subcontracting formed 10% to 20% of a project—

**Mr Carson:** I am on the policy side, and it would be the operational people who would take those decisions.

**The Chairperson:** I am just trying to get a sense of what the threshold is.

**Mr Carson:** We can come back to you if you are looking for specific figures on that, but I would not like to pin my figures to the mast. As I said, I am on the policy side.

**Mr Weir:** Thank you, Chairperson; you jumped in and managed to ask the question that I was going to ask.

Mr Carson, I appreciate that you are not from the operational side and do not want to give us figures. Clearly, it would be wrong of you to give us figures that could potentially mislead. It is right that you are cautious. Is developing those figures a work in progress? Do you envisage that the operational side would operate in such a way that a specific set of criteria would have to be met to create the project bank account? Or, is it more that you would analyse on a case-by-case basis to get a feel for the appropriateness? What way do you see that operating?

**Mr Carson:** The use of project bank accounts will develop. We are looking at the position in the rest of the UK. Project bank accounts are used quite extensively in GB. They started off being used in higher-value projects, but are now used more widely. Indeed, in the future, the default position for government contracts will be that project bank accounts will be used. We have set the levels here, at the moment, to run some pilots to see how the local situation responds to project bank accounts. We will work with the industry in doing that. We will be monitoring the results of that to look at how they can be applied going forward.

**Mr Weir:** To pick up on the Chairperson's point: if you are looking at a series of pilots, is it on the basis that you would pretty much accept any pilot that falls within the criteria of the bid, or do you have a specific idea of what you want? For sake of argument, do you want to run 10 pilots at this stage?

**Mr Carson:** Any project being procured by CPD valued at over £1 million will be considered for a project bank account.

**Mr Weir:** What do you envisage the timescale for evaluation and roll-out to be? Are you waiting to evaluate all the pilots before you move ahead with a wider roll-out? I think I picked you up correctly when you said that, once you got through the initial phase, you would eventually reach the stage where project bank accounts would be the default position more or less.

**Mr Carson:** That appears to be the position now in GB. There are two issues. There is the value of the projects themselves and how we apply project bank accounts; then there is the level of supplier involvement that we would want to participate in the project bank account. At the moment, we have restricted that to first-tier subcontractors. However, the potential exists for it to go to second-tier subcontractors. All of these issues are on the table. Over the next six to 12 months, we will be monitoring the implementation of the projects that have been identified.

**Mr Weir:** So, depending on the results of that, will you then be looking at a wider roll-out in about a year's time?

**Mr Carson:** There may indeed be other COPEs that wish to proceed in advance of that.

**Mr Weir:** Presumably, to some extent, the roll-out will be a bit dependent on the evaluation. If you find that the processes being put in place on project bank accounts have operated well and been a success, you will perhaps move more swiftly towards a roll-out. If you find a situation in which there is some level of teething difficulties or certain things are not working, that obviously will affect the speed of the roll-out. In the worst-case scenario, if it is a complete disaster, you would not be rolling it out at all.

**Mr Carson:** I would not want to give the impression that there is a lot of uncertainty.

**Mr Weir:** I understand that. It is not an entirely untested idea; it is something that has been commonplace elsewhere. So, consequently, there should not be major problems. I suppose we want to make sure that there are no teething difficulties, particularly from an operational point of view.

**Mr Carson:** Yes, that is quite right. At this stage, we do not envisage any major difficulties. We anticipate that anything that comes up will be relatively minor in nature. The mechanisms are fairly simple. They are accepted by the banking industry, so they are well tried and tested. We should have a relatively smooth implementation period here.

**The Chairperson:** For clarity, what are first-tier subcontractors and what are second-tier subcontractors?

**Mr Carson:** First-tier subcontractors are paid directly by the main contractor. Second-tier subcontractors work for the first-tier subcontractors, so they, in turn, potentially subcontract some of the work that they are responsible for.

**The Chairperson:** Why could they not apply for funds from the bank account? They would not go through first-tier subcontractors.

**Mr Carson:** At the moment, we are restricting it to first-tier subcontractors, but that is a potential avenue that we could go down in future.

**The Chairperson:** Is that done in Britain at the moment?

**Mr Carson:** I believe that it is done in some contracts in Britain. However, those contracts may be a lot larger than the value of the contracts that we are looking at here. This needs to be taken into account.

For a project bank account to make sense, significant or substantial material cash flows need to go out to the subcontractor.

**The Chairperson:** Given the number of projects that will be under £1 million, the question will be about the safeguards that the Department is putting in place for subcontractors that work on those jobs.

**Mr Carson:** Yes. We have put a range of measures in place. As I said at the outset, we have been discussing with the industry the problems around prompt payment for quite some time. The Minister has drawn attention to those problems on a number of occasions, and he has announced his determination to address them. We have agreed with the industry that, when projects are being put out to tender, confirmation will be sought from the main contractor — the tenderer — that full account has been taken of the price of any subcontracting elements in the overall price.

The contract terms between the main contractor and the subcontractor will be subject to acceptance by the Department. In doing that, the Department will look to see that the payment terms are appropriate and that they reflect the terms that are being applied to the main contractor. Perhaps the most important point is that when a contract is in place there is now guidance stipulating that the contractor has to provide regular information on payments to subcontractors to allow the project manager on the contract to validate the fact that payment is being made in accordance with those payment terms.

**The Chairperson:** It is stated that subcontractors need to report instances of late payment so that those may be investigated by the relevant COPE; but you are saying that that should be picked up anyway. There is that culture out there that subcontractors do not report on the main contractors.

**Mr Carson:** Yes. Those will be picked up as part of that procedure. A guidance note was issued in July. Those change processes are feeding their way through the system. Our initial feedback is that they are working and that payments are being made by the due dates.

**Mr D Bradley:** Paragraph 7 of your paper, under "key issues", refers to the exclusion of poor-performing contractors from tendering for contracts in the future for failure to comply with prompt payment conditions. You say that that came into force in January. Was that January 2012?

**Mr Carson:** Yes.

**Mr D Bradley:** Has any action been taken against a contractor in the past year?

**Mr Carson:** Not that I am aware of. It has changed the dynamic between Departments and contractors in that it has been widely publicised and they are now aware of the penalties that can be applied. There is a change of emphasis in the whole sphere of contract management, which is

ensuring that contract conditions are met. There is now a direct incentive, which was not there before, for contractors to make sure that that is taking place.

**Mr D Bradley:** As a matter of interest, if you were to exclude a poor-performing contractor, would that decision be open to legal challenge?

**Mr Carson:** Yes, a legal challenge could be taken. However, the process is very clearly set out in the guidance and in the contract documentation. A supplier who is not performing adequately on a contract will be given two opportunities to address the issue, and only when that has failed will exclusion be considered. There are plenty of opportunities for the supplier to avoid that outcome.

**Mr D Bradley:** The papers that you sent us show various statements by the Minister and how all the new measures have been publicised, yet only seven businesses have signed up to the prompt payment code. Is that not very disappointing at this stage?

**Mr Carson:** There is a fair payment charter in the construction sector, and we have agreed with industry that all parties to a contract shall sign up to that. That is being signed up to.

**Mr D Bradley:** Do you have any figures on the number of companies that have signed up to that aspect?

**Mr Carson:** They all should. Any company that is contracting with government should be a signatory to the prompt payment charter.

**Mr D Bradley:** Is the prompt payment code voluntary?

**Mr Carson:** I believe that the prompt payment code is a different —

**Ms Hamill:** The prompt payment code is an independent organisation for businesses to sign up to commit to paying each other. It is voluntary.

**Mr D Bradley:** Is it connected with the Department or procurement processes?

**Ms Hamill:** No.

**Mr D Bradley:** OK. I saw it reported on in your papers. Thank you.

**Mr Cree:** It seems pretty frustrating. This matter came up four or five years ago, and the big difficulty was that subcontractors were not being paid and were being forced into liquidation. The reason is that it is very difficult for a subcontractor to take a civil action against the fellow who is feeding him. However, the matter was taken on board, and we were assured — the Minister was very supportive in this — that the terms had been changed and that, at each monthly meeting, there would be a requirement for the contractors and subcontractors to ensure that the subcontractors get their money. Is that still the case?

**Mr Carson:** That is the case.

**Mr Cree:** So, we now want to move on, presumably with a view to improving it?

**Mr Carson:** It is the case in CPD. It is for every Department and COPE to make sure that those procedures are being applied across the system and implemented properly. In CPD, they are, and as I say, the feedback we are getting is that they are having a good effect.

**Mr Cree:** Does that mean that subcontractors are assuring CPD that it is working?

**Mr Carson:** Yes. We have not found anybody saying to us that it is not working. In some instances, issues have come up during the project manager's review of the payment information, but those have been investigated and resolved. So, any failure to pay by the main contractor should be picked up through that exercise.

**Mr Cree:** Presumably the money going into the project bank account comes from the client? Does the client make staged payments? Is that how it works?

**Mr Carson:** That is right. There is an agreement about what is due at particular stages of the contract and about what elements relate to the main contractor and the specified subcontractors. The money goes into the account from the client or the Department and is then held in trust for those beneficiaries and paid out within five days of it going into the account. If those project bank account arrangements are in place, the liquidation of a main contractor, for example, which you mentioned earlier, will not have a knock-on effect on the subcontractor.

**Mr Cree:** OK. You pointed out what size of project would trigger the use of a project bank account, and you spoke of £1 million-plus, depending on the mix of the subcontract element. If I got you correctly, you said that if there were, for example, a big mechanical engineering aspect to it, it would be highlighted. Surely, the opposite is the case, because you could have a contract with many small subcontractors that would be, arguably, more important than the main one, and a lot of contracts could include all sorts of specialist services right across the mechanical and engineering section.

**Mr Carson:** It would depend on the arrangements that are in place. You could find that a subcontractor is in the lead and that the other services are second-tier subcontractors working for the first-tier subcontractor.

**Mr Cree:** I am sorry; I will stop you there. At what stage are subcontractors nominated? When the main contractor is putting his tender together, for example, you do not know who the subcontractors might be.

**Mr Carson:** No.

**Mr Cree:** So, at what stage are they nominated? Is it after the contract is granted?

**Mr Carson:** No. They are identified prior to the contract award. The guidance we have at the moment requires the client, or the Department, to accept the subcontractors on to the contract. On those contracts where the subcontractor element is so significant that an assessment of the subcontracting element is required in order to arrive at the preferred bidder, it is expected that those subcontractors will be retained for the contract.

**Mr Cree:** Do you know their identity and the value of their subcontract?

**Mr Carson:** Yes. As I said, we look at the subcontractors' terms and conditions in the contract between the main contractor and the subcontractor.

**Mr Cree:** This is my last point. How can we be sure that the main contractor does not then use other subcontractors on the job and change his policy? It is quite common practice for the main contractor to renegotiate subcontracts once contracts are granted.

**Mr Carson:** Where a subcontractor has been nominated and assessed as part of the bid, they will be replaced only if there are compelling reasons to do so. In other cases, we recognise that a contractor could get a price from subcontractor A and award it the work. However, it may be that subcontractor A has a different job or has too much work on to carry the work out. So, although Departments will accept the subcontractors on the contract, we would not necessarily view a change of subcontractor as being detrimental. We require the main contractor to say that the subcontractor prices have been taken into account in the price of the contract, and we can check with the subcontractors to make sure that that is the case.

**Mr Cree:** The danger is, and there are many examples of this, that subcontractors will end up being screwed on the price, and the difference will be kept as main contractor profit. How do you protect against that?

**Mr Carson:** As I said, we require the contractor to confirm that the subcontractor price has been included in the price of the contract. We will confirm that. If there is any representation made to us, we will confirm that with the subcontractor. If it is discovered that the full price has not been included in the tender, we will look at that very carefully.

**Mr Cree:** There is a whole area of concern in there that needs to be looked at further, because that is what is happening with a lot of the contracts on the ground. Poor subcontractors are forced into a situation and are told to take it or leave it. The difference between the original tender price that was accepted and the price that the subcontractor eventually gets is extra profit for the main contractor.

**Mr Carson:** Where there are cases like that, we would be very interested to know the detail of them.

**Mr Cree:** How will you identify them? Will it be up to CPD to identify them?

**Mr Carson:** 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.

**Mr Cree:** It is very difficult to ask them to do that bearing in mind that they are being fed from the main contractors. I suggest to you that it is a weakness in the system.

**Mr Carson:** It is something that we certainly can look at.

**Mr Cree:** Thank you for that.

**The Chairperson:** As regards the protocol for poor construction performance and the threat of the one-year exclusion from the Government tender, I am still not clear about the threshold being imposed on a contractor. Is it a case of three strikes and you are out? How strict will the Department be with that measure?

**Mr Carson:** It can be applied in any contract. If a contractor is not meeting the terms and conditions of the contract, the protocol can be brought into play. As I said, the contractor will be given opportunities to remedy the issue, but where he fails to do so he can be issued with a certificate of poor performance, which will lead to his exclusion from government opportunities.

**The Chairperson:** So, if a contractor does not pay the subcontractors within 30 days, do you foresee a certificate being imposed for that alone?

**Mr Carson:** Where a contractor does not fulfil the terms in the contract to meet the deadlines for subcontractor payments, we expect that to be addressed by the main contractor. However, where that continually fails to be addressed, the contractor will be a candidate for a poor performance certificate. It is a decision that is made by the client.

**The Chairperson:** You refer to the terms and conditions of the contract. Do you expect much variance in the condition on non-payment within difference public sector contracts?

**Mr Carson:** Do I expect much variance?

**The Chairperson:** Yes.

**Mr Carson:** I am not quite sure what you mean by that.

**The Chairperson:** If a contractor does not pay subcontractors within 30 days, would that be the same across nearly all public sector contracts, or would there be any variance? There needs to be a clear message. As representatives, we need to know how strict the Department is going to be on late payments if that happens repeatedly.

**Mr Carson:** Thirty days is the standard term, and that should be in all contracts for a start. In relation to application of the poor performance protocol, because of the emphasis that is being placed on prompt payment, that would be a primary candidate. I would expect all Departments to apply that in all of the contracts that they have.

**The Chairperson:** Have there been any referrals for exclusion as yet?

**Mr Carson:** I am not aware of poor performance certificates being issued, but there is a protocol. There may be contract managers who have implemented the first stages of the process, but a contractor has opportunities to address the particular problems or issues to get them resolved.

**The Chairperson:** In terms of the project bank accounts, what percentage of projects in the public sector would CPD be responsible for? Obviously, CPD manages projects for other Departments on occasions. How many projects do you see coming forward in the next six months that project bank accounts may be applicable to?

**Mr Carson:** In the past couple of years there have been 10 or 11 projects procured by CPD that have been valued at over £1 million. I do not have the figures for the next period, but I know that a number of contracts exceed that value. The peace and reconciliation centre at the Maze is one such project, and there are some other infrastructure projects that will be coming up in the near future.

**Mr Girvan:** I want to go back to the point that Leslie raised. Having worked in the industry, I am aware of what goes on. A term used is "write-offs against the debt", so when you put in an invoice, as a subcontractor, to the lead contractor, there is an understanding that your quantity surveyor and their quantity surveyor are going to disagree and that, ultimately, there will be a compromise reached. That compromise on the payment is always chipped quite a bit. It happens on every contract, whether it is a government contract or not. Lead contractors sometimes tender low to get a contract and then expect the subcontractors to take the hit so that they make money out of it at the end. That invariably happens.

From the Department's point of view, it seems that you are oblivious to that going on. I know that it happens day and daily. I have been at meetings in which we have had to fight across the table over £20,000 and they have said that they will offer us a payment of £50,000 and we should take it, or take them to arbitration. If you go to arbitration, that can cost you a lot more money. You will make the judgement to accept it and move ahead, and you will work for that contractor again, because, invariably, there are jobs out there that you have to chase. That is what goes on.

In relation to local banks, I appreciate that there are two banks mentioned in relation to project bank accounts — Barclays and the RBS. Have any local banks indicated a willingness to open and use project bank accounts? Most local contractors will be working with local banks, as opposed to the RBS and Barclays, both of which are not without their problems. Some of our local banks feel that they are being left out of the loop on some of that.

**Mr Carson:** We had discussions with one local bank, which indicated that it was able to provide that service. I do not think that there is an issue with getting local banks involved, because, as I said, the products are well known in the banking industry. There is no risk for the banks in providing the service, so we do not anticipate any difficulty.

**Mr Girvan:** You are bound to be aware that write-offs are going on. It is endemic throughout the industry.

**Mr Carson:** I take the points that you made about the price that is bid for some contracts being unrealistic. We are very aware of that issue. The Minister has made announcements to the effect that abnormally low tenders will be rejected. We are working at the moment with the COPEs to produce some operational guidance on how that will be applied in practice. Our intention is to not accept any bid that is unsustainable, partly because of the potential impact for the supply chain to that contract.

**Mr Girvan:** Prompt payment can be made only on certificated quantity surveyor (QS) reports. If those QS reports show a difference between one person saying that the subcontractor is completing or is 50% of the way through a job and he has put in an invoice for that job, and his QS agrees that it is 50%, but the lead contractor says that he is only 30%, even though he might well be 50%, is there any mechanism to allow that arbitration to take place?

**Mr Carson:** The amounts that are due for each element of a contract will be decided between the —

**Mr Girvan:** The lead contractor will agree that it is 50%, but he will ultimately try to chip the subby to say that it is only 30% of his job. It might be 50% of another.

**Mr Carson:** If he agrees 50% with the client, the project manager will look to see that the subcontractor gets the full element to which he is entitled.

**Mr Girvan:** So, it is on the invoice that is agreed, and the subcontractor will have had to be bought in to the invoice that is submitted?

**Mr Carson:** Absolutely.

**Mr Girvan:** That is fine.

**The Chairperson:** What is the Department doing in respect of sub-economic tendering? That is, perhaps, a bigger issue for the construction industry.

**Mr Carson:** Yes. As I was saying, we are talking to the COPEs about issuing guidance on how we would treat sub-economic tenderers. Certainly, the intention is to exclude, except where a contractor can demonstrate that they are able to deliver the contract and explain the reasons why it has come in at such a low price. We will look for those explanations to come from the highest levels of the organisation.

**The Chairperson:** When will that guidance be forthcoming?

**Mr Carson:** We are working on it at the moment. If it is not out this month, we will certainly look to do something next month.

**The Chairperson:** Is the guidance sufficient? In a number of countries — Holland is an example — when they receive a number of bids, they calculate the average of the submitted bids, and, rather than the lowest bid being successful, it is one somewhere in the middle. From reports, that seems to be successful. Have you considered that at all?

**Mr Carson:** Yes. We looked at various ways of approaching the sub-economic tendering issue. The calculation of an average and the rejection of a bid if it is outside a particular range of that average might be one way that it could be applied. There are different mechanisms in place in various regions. We are looking to see which one is the most appropriate for here.

**The Chairperson:** Fiona and David, thanks very much. That was useful.