Calling Time on Public Sector Late Payment

Preparing for the impact of new payment legislation, incentivising a responsible business culture and strengthening supplier relationships

OXYGEN FINANCE

Contents

Foreword: Andy Sawford MP, Shadow Local Government Minister

"The landscape for procurement policy and payment implementation is due to change rapidly"

There are significant changes in the pipeline for public sector procurement policy. E-procurement, e-invoicing and increased transparency on payment performance will all feature in incoming legislation, plus the OJEU regime is set to become more simple and flexible for all parties. We will of course be looking to support measures that protect the use of taxpayers' money but we also want to see businesses generally, and SMEs in particular, start to see real benefits from these positive steps in the short term.

Local authorities have long been conscious of their duty to be prompt payment exemplars. However, the forthcoming changes will see much increased transparency in this area and will make public the very real financial liabilities associated with poor performance. 'Satisfactory' performance can no longer be acceptable. Any valid invoices which are not paid to term will now represent an unnecessary and potentially significant cost to the tax payer. We are very proud of the work that is already being done around the country, for example in Oldham Metropolitan Borough which has pioneered an early payment solution that not only helps accelerate money into the economy but also ensures all invoices are paid to term and generates some much needed new income.

We all know that predictable cashflow is a crucial factor in the health of our SMEs and so we support the principles of the prompt payment code. That said, payment on day 31 under a 30 day agreement would mean shame for the 'late' payer, but payment on day 89 under a 90 day agreement would continue to be considered both 'prompt' and acceptable. Unfortunately, hard experience has shown that some market participants have responded to this government initiative by extending their payment terms from 30 days to 60 days and even 90 days in some cases Ironically, the call to `name and shame' has actually harmed SMEs. We know that for many businesses, the effect of this buyer behaviour is very challenging. We must now address this gross differentiation to emphasise the importance of early, rather than prompt payment.

Of course, that begs the question: how do you incentivise a buyer to pay earlier? In Oldham's programme, suppliers are offered the option of paying a small fee in return for accelerated payment and this is an innovative solution we are considering.

However, it is the drive to be more business friendly that is most interesting in developing those supply chain relationships and the first step is the removal of the friction caused by late and irregular payment. The changes coming down the track should be good for business growth and improving efficiency in our councils. I would urge you to embrace them.

Introduction: Pay now or pay the price

SMEs in the UK are currently owed an estimated £40 billion in overdue payments. A major drag on local growth, this is a problem not just for the private sector but for the public sector too.

Recent research from the Asset Based Finance Association (ABFA) has found that a worryingly high proportion of local authorities are failing to meet the 30 day payment period required by law, with the average wait still in excess of 40 days for some local authorities. Given that SMEs make up almost half of the UK economy and with an estimated 60% of SMEs affected by late payment , this is not just a problem of payment performance, but of economic stability.

Local authorities, and the wider public sector, have a chance to show real leadership in tackling both the culture and practice of late (and inconsistent) payment.

Good relationships with SMEs are paramount to local economic growth and improving cashflow in local economy supply chains is a critical area that the Government has been exploring recently to meet the local growth challenge. A number of local authorities are leading the way in this area, making headlines for their success in transforming procurement and accounts payable processes and championing local business as a result. But, with the new legislation posing significant financial risks for local authorities in transforming the transparency and compliance of their payment processes, the problems of ongoing late payment are reputationally damaging for both local authorities and their supply chains.

Local authorities need to act now to safeguard themselves and their local economies from the threat posed by late payment.

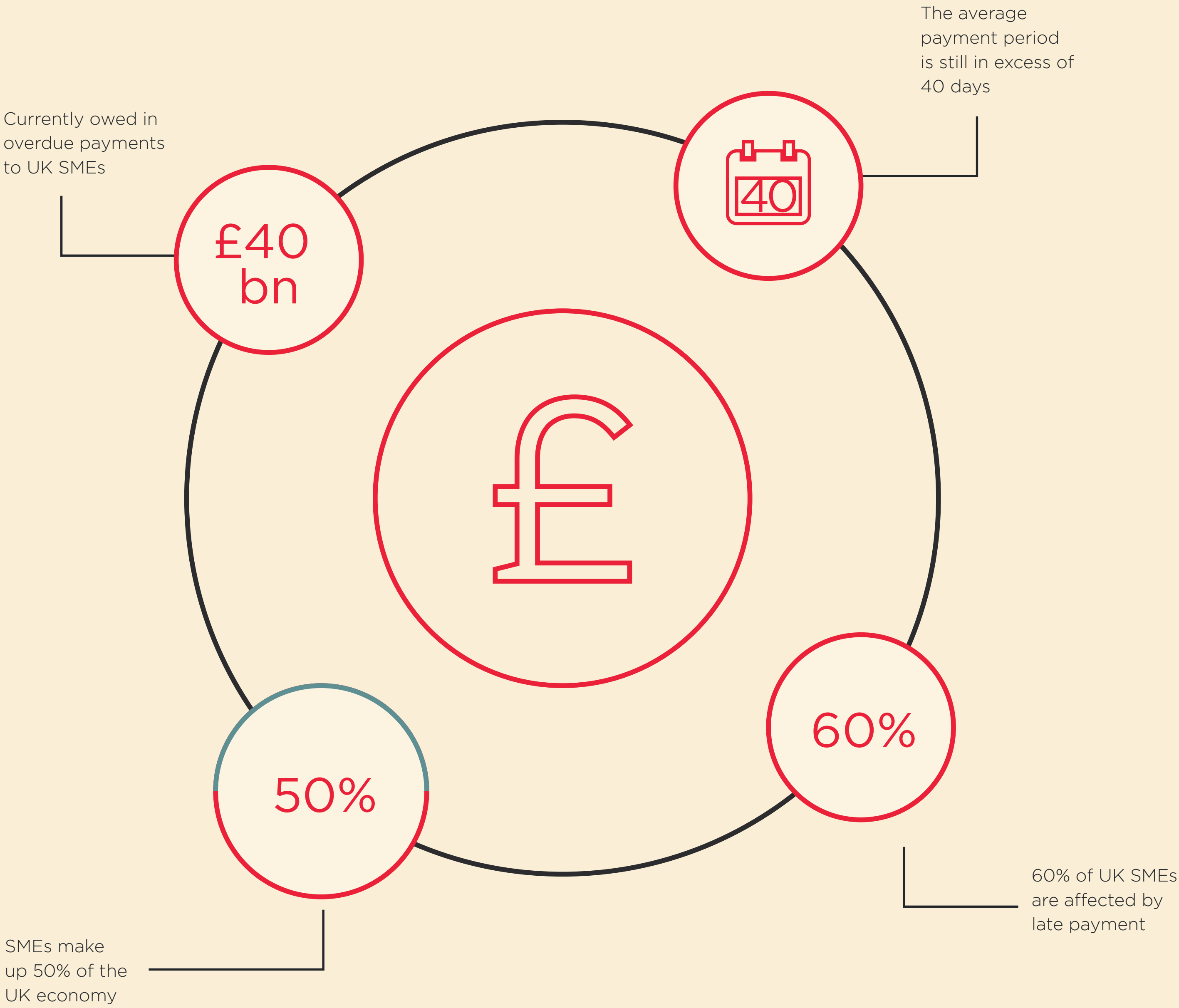
> "SMEs make up almost half of the UK economy, with an estimated 60% of SMEs affected by late payment"

1. http://www.abfa.org.uk/news/2014/August/News11082014.asp

2. House of Commons Library Note SN/EP/6078: Small businesses and the UK economy. 13 June 2014 The European Commission's SME Performance Review estimates the Gross Value Added of SMEs as ₵473 billion or 49.8% of the UK economy.

3. Bacs: UK companies face a late payment burden of £46.1billion. Sixty per cent of UK SMEs are now experiencing late payments, with the average SME waiting for £38,186 in overdue payments.

http://www.bacs.co.uk/Bacs/DocumentLibrary/UK_companies_face_a_late_payment_burden_of_%C2%A346.1_billion.pdf


The average payment period is still in excess of 40 days
40
Currently owed in overdue payments to UK SMEs
£40 bn
£
60%
60% of UK SMEs are affected by late payment
50%
SMEs make up 50% of the UK economy

The late payment problem part 1: A ticking time bomb for public finances

Local councils have long been encouraged to act as prompt payment exemplars and ensure that their suppliers receive payment on time against (the statutory) 30 day terms. Many authorities will perform well against this measure whereas others will recognise they have work to do.

“Under the incoming legislation, this payment performance will translate to a minimum financial liability of c £1.1m”

The integration of the EU Directive on Public Sector Procurement into UK law poses a potentially worrying challenge for public sector bodies with its legal requirement to open up payment performance reporting. Not only are public authorities now required to publish annually the number and value of invoices they have paid late, they will be forced to apply the financial penalties inherent within the Late Payment of Commercial Debts Act to calculate and report the late payment liabilities they “have or should have” paid.

There is no formal guidance, as of yet, as to whether these liabilities could be retrospective or indeed cumulative. However, there is no doubt that this increased transparency poses a significant financial risk for authorities who are currently unprepared. The question of when the clock starts ticking is fundamental to this problem – authorities who treat day zero as the first day the invoice is logged into their accounts payable system may soon fall foul of more stringent processes requiring them to act faster.

The NHS is leading the way here on reporting and transparency as they already incorporate the Better Payment Practice Code into their annual report and accounts (example disclosures below). This code ensures that the total number and value of invoices received during the year as well as the payment performance are published at least annually. Importantly, all calculations are carried out excluding invoices in dispute.

Using this example, 27,323 invoices were paid late during the year. Under the new legislation, this payment performance will translate to a minimum financial liability of c £1.1m .

Fundamentally, strong supplier relationships are critical to the delivery of services by local authorities and more must be done to address these important issues which can compromise these relationships. By continuing to pay invoices after the statutory 30 day deadline, public authorities are increasing their financial risk to new EU legislation – a ticking time bomb for local government finance.

Better payment practice code — measure of compliance

	2013/14 number	2013/14 £000s	2012/2013 number	2012/13 £000s
Total bills paid in year	135,643	409,081	111,726	348,287
Total bills paid within target	108, 320	354,458	59,858	276,985
% of bills paid within target	79.86%	86.65%	53.58%	79.53%

The Better Payment Practice code requires the Trust to aim to pay all valid non NHS invoices by the due date or within 30 days of receipt of goods or a valid invoice, whichever is later.

The late payment problem part 2: Quietly undermining the economy

The latest research from Bacs Payment Schemes Limited (Bacs) shows that the late payment debt burden shouldered by UK businesses has reached £46.1 billion. Bacs, the company behind Direct Debit, looked at Small to Medium Enterprises (SMEs employing up to 250 people) and large corporates (employing 250 plus people) throughout the UK. The research shows quite clearly that SMEs are being forced to carry the larger debt burden of £39.4 billion, while corporates are owed £6.7 billion at any one time.

Sixty per cent of UK SMEs are now experiencing late payments, with the average SME waiting for £38,186 in overdue payments. One in four SMEs admits that if the amount they are owed grew to £50,000 it would be enough to send them into bankruptcy. In contrast, the average corporate is owed almost a million pounds.

On top of that risk, estimates show that UK businesses are being forced to bear additional costs of c£9 billion a year due to late payments with around a third saying they're spending around £500 a month as a consequence of money owed to them. And, according to the research, this figure can be as high as £10,000 a month as a result of the various costs associated with bad debts, including the likes of overdraft fees and administrative costs – with one in four companies spending over 10 hours a week chasing late payments.

The knock-on effect of late payments means that a quarter of companies are being forced to pay their own suppliers late, with one in five saying that late payments are forcing them to rely on bank overdrafts. In terms of the extended period that companies are kept waiting for payment, more than three quarters of companies surveyed said settlement was being delayed a minimum of a month beyond their agreed payment terms. The research reports that businesses in Scotland and Northern Ireland experience the highest levels of late payments with 67 per cent and 66 per cent respectively claiming to have been left waiting for invoices to be paid. In England and Wales, the figures stand at 62 per cent and 59 per cent.

The National Audit Office (NAO) report "Paying government suppliers on time" released in January 2015 highlighted the early payment challenge facing central government. Most notably it finds that, despite positive intent from the government on the issue of prompt and early payment, four central government departments do not even record the date when invoices are first received leading to poor payment practice. This fundamentally challenges any notion local government or other public agencies may have that following the lead set by central government is good enough.

If the public sector cares about the health of the local and national economy, it is vital that individuals take responsibility for the payment culture within their own organisation and put in place sustainable measures to guarantee prompt or early payment to their suppliers.

4. http://www.nao.org.uk/wp-content/uploads/2015/01/Paying-government-suppliers-on-time.pdf

> “UK businesses are being forced to bear additional costs of c £9 billion a year due to late payments”

£46.1bn

The late payment debt burden shouldered by UK businesses

£50,000

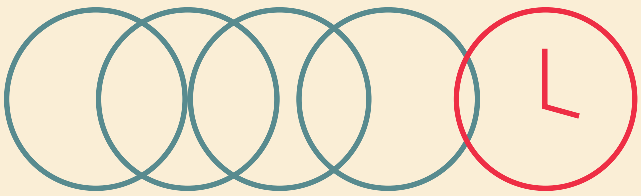
25% of SMEs admit if the amount they are owed grew to £50,000 it would be enough to make them bankrupt

£38,186

The average amount an SME is waiting for in overdue payments

25%

of companies are forced to pay their own suppliers late



Conclusion: Why paying early is a win for all parties

It is critical that the public sector does not lose sight of the important role played by regular suppliers who deliver the essential services on which communities across the UK rely. This report sets out the current scale of the problem of late payment and how some authorities and support networks are taking the lead in incentivising and embedding a culture of early payment and good business practice for economic growth.

Nationally, the definition of what constitutes late payment is still too vague to drive change and the challenges experienced by the prompt payment code have proved that an alternative approach is desperately needed. It is clear that asking suppliers to wait up to sixty days for payment undermines supplier confidence and stems the flow of finance in the system.

Already, many public sector organisations are starting to recognise the broad opportunity presented by early payment and most importantly, that their suppliers and communities can benefit from the 'no income, no fee' system operated by organisations such as Oxygen Finance.

Now is the right time for local government to raise its game further and take the initiative to embed good business practice and payment culture. We cannot afford to wait.

This is why we are calling on all local authorities across the country to back a five-day payment challenge.

This challenge provides a unique opportunity for all of us to support both sides in the buyer-supplier relationship, through a model that will incentivise buying organisations to pay quickly in such a way that they, as well as their suppliers, can benefit.

> "Organisations are starting to recognise the broad opportunity presented by early payment"

Case Study: South Tyneside Council

Businesses supplying goods and services to South Tyneside Council are set to benefit from the introduction of a new early payment scheme.

More than 3,000 suppliers help the Council to provide a wide range of key services, from books and materials in schools and libraries to health and wellbeing services, highways maintenance and waste disposal.

As members of the Supplier Incentive Programme (SIP), companies that sell to the Council will have their invoices fast-tracked weeks in advance in exchange for a small cash return or discount. This gives suppliers the ability to alleviate potential cash flow problems by giving them quicker access to their payments.

The voluntary programme also has a number of key features to benefit businesses. Suppliers not only get paid early, free access to e-invoicing, same day invoice processing and dedicated account contacts make payment processing more efficient. Businesses also develop closer long-term relationships with the Council.

Councillor Iain Malcolm, Leader of South Tyneside Council, said: "Stimulating economic growth is one of our key priorities here in South Tyneside.

"Businesses, particularly small and medium sized firms, are the backbone of our economy therefore we feel it is important we do all that we can to support them through these challenging financial times.

"Through the Supplier Incentive Programme and paying businesses early we can help our key suppliers to keep their cash flowing and hopefully ease the financial burden for businesses, which often need to fund the gap between payments. It is also an excellent way for us to strengthen our relationship with suppliers.

"The scheme will also benefit the Council with invoices dealt with much more efficiently and with money generated from early payments going straight back into protecting the vital Council services our residents value and deserve."

South Tyneside Council is working with Oxygen Finance to implement the Supplier Incentive Programme, which has already proven popular since being introduced in other parts of the country.

Martin Swales, Chief Executive of South Tyneside Council, said: "The Supplier Incentive Programme is a key initiative for the Council and is part of our commitment to supporting business growth and the economy.

"It enables the Council to work more commercially and efficiently with improved payment processes and performance. Prompt payment is also better for business and will be of huge benefit to our valued suppliers as well as companies further down the supply chain.

"The scheme is just one of the ways we are developing our approach to working with our suppliers and we see it as an excellent way of building positive long-term business relationships. We believe closer collaboration between the public and private sectors is also central to helping to boost economic growth."

The Council is contacting suppliers with details of the scheme and how they could benefit. Suppliers to South Tyneside Homes, which manages and maintains around 18,000 properties in the Borough on behalf of the Council, could also benefit from the initiative.

Public Sector Payment Performance: facts all public authorities need to know

Public Sector Payment Performance: facts all public authorities need to know

Background

Late payment of supplier invoices continues to be a major drag on the UK economy; some £46bn is now considered overdue. £40bn of this is outstanding to SMEs, forcing them to utilise precious credit facilities to plug the cash-flow gap rather than being available to invest for growth. Late payment frequently causes a ripple effect down the supply chain, thus amplifying the problem, and is one of the leading causes of SME bankruptcy.

The government is well aware of the challenge and is very active in promoting and enforcing a 'responsible payment culture'.

Executive summary

- The Government agrees that more can be done to ensure the public sector is an exemplar of good payment practices
- Under the new proposals, all public authorities will be required to publish their payment performance in detail and also calculate and apply the financial penalties inherent within the late payment of commercial debts act - regardless of whether they have paid these amounts or not
- Estimates show that a typical upper tier Authority could be faced with a new and visible annual liability of between £300,000 and £750,000 unless they can comply with the changes
- The need exists for public authorities to ensure 100% compliance with the 30 day payment standard

5. Legislation, Codes & Consultations
- EU Directive on Late Payment
- The Late Payment of Commercial Debts Regulations 2013
- EU Directive on E-invoicing
- EU Directive on E-procurement
- EU Directive on Public Sector Procurement
- Local Government Procurement Inquiry
- Business, Innovation & Skills consultation on 'Building a responsible payment culture'
- Small Business, Enterprise & Employment Bill
- Prompt payment code

Facts: General

1. For public authorities the current situation is that the payment period must not exceed 30 days following receipt of the invoice.

The details of this are set out in the Business Innovation and Skills (BIS) User Guide to the re-cast EU Late Payment Directive, [6] the Public Contracts Regulations 2015 [7] and accompanying Guidance [8] and the Small Business, Enterprise and Employment Bill 2014-2015.[9]

According to the EU press notice, 'If the date or period for payment is not fixed in the contract, the creditor will be entitled to interest for late payment after 30 days following the date of receipt of the invoice.' [10]

The United Kingdom Government's website [11] explains it slightly differently, saying:

'If you haven't already agreed when the money will be paid, the law says the payment is late after 30 days for public authorities and business transactions after either:

· the customer gets the invoice
· you deliver the goods or provide the service (if this is later)' [12]

It is generally understood that 'receipt of the invoice' is interpreted as the arrival, in paper or electronic form, at the public authority's place of business. The guidance issued to support the Public Contract Regulations 2015, which came into effect on the 26th February 2015, states "Late payment legislation enables suppliers to claim statutory interest for payments made more than 30 days after receipt of the invoice." This is based on Regulation 113 of the Regulations which define the start of the 30 day period as "that any payment due from the contracting authority to the contractor under the contract is to be made no later than the end of a period of 30 days from the date on which the relevant invoice is regarded as valid and undisputed."

· The guidance does, however, give the contracting authority seven days leeway to verify contested invoices; "The contracting authority must verify the invoice in a timely manner e.g. check that what was ordered and received matches what was invoiced and / or that the charges are correct. As a guide contracting authorities should verify invoices in 7 calendar days of receipt."

2. BIS are currently developing a new statutory framework on payment practices and performance. This will be enforced on all public authorities and 'large' private businesses.

The Government's May 2014 response [13] to its December 2013 consultation paper Building a Responsible Payment Culture [14] said that there would be a 'robust reporting framework' to increase transparency on payment practices, with a legislative underpinning. The Small Business, Enterprise and Employment Bill [15] includes provisions [16] that would allow this to be put in place for larger companies.

3. The Government is bringing forward legislation in the form of the Small Business, Enterprise and Employment Bill to further reforms to streamline procurement and improve public sector payment practices, including a requirement for public authorities to (i) accept e-invoices and (ii) run timely and efficient procurements as well as (iii) provide greater powers for Ministers to investigate complaints raised by the Cabinet Office's Mystery Shopper scheme.

The Government has produced a helpful fact sheet [17] on these initiatives.

4. The transposition of the EU Directive on Public Sector Procurement into UK law includes a legal requirement for all new public sector contracts to include 30-day payment terms for all the contracts in the supply chain.

This proposal is contained in Regulation 113 of the Public Contracts Regulations 2015 which came into effect on 26.02.2015.

5. The National Audit Office has recently published a report to examine how Central Government departments process invoices, calculate their prompt payment performance and ensure that main contractors comply with their obligations on subcontractors.

The findings were published on 08.01.2015 [18].

6. www.gov.uk/government/uploads/system/uploads/attachment_data/file/360834/bis-14-1116-a-users-guide-to-the-recast-late-payment-directive.pdf

7. http://www.legislation.gov.uk/uksi/2015/102/contents/made

8. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408142/Prompt_Payment_Lord_Young_Guidance.pdf

9. http://www.publications.parliament.uk/pa/bills/lbill/2014-2015/0091/15091.pdf (as amended and subject to revision)

10. europa.eu/rapid/press-release_PRES-11-6_en.htm

11. www.gov.uk

12. www.gov.uk/late-commercial-payments-interest-debt-recovery

13. www.gov.uk/government/uploads/system/uploads/attachment_data/file/315462/bis-14-793-building-a-responsible-payment-culture-government-response.pdf

14. www.gov.uk/government/uploads/system/uploads/attachment_data/file/273436/bis-13-1234-building-a-responsible-payment-culture.pdf

Facts: Financial

1. The recast EU late payment legislation came into force on 16th March 2013. The BIS User Guide to the recast EU Late Payment Directive explains these new requirements;

2. The guide states public authorities must:

- pay invoices within 30 days
- if payment is not made within this deadline, the authority is obliged to automatically pay the outstanding amount that includes daily interest for every day payment is late based on 8 percentage points above the Bank of England's reference rate plus the fixed amount (fee or penalty), depending on the size of the unpaid debt
- accept responsibility to pay the supplier on time; the supplier is not obliged to remind the authority that payment is outstanding
- the fixed amount is £40 per invoice for invoices below £1,000 rising to £100 per invoice for invoices above £10,000
- be responsible for any additional compensation claimed by suppliers, including additional compensation for reasonable costs in recovering the incurred debt

3. There is no evidence public authorities are automatically adding these penalties when invoices are paid late.

   The Institute of Credit Management has said that it is "not aware that interest is automatically being paid'. The House of Commons Library has also confirmed that it has "not seen evidence of public authorities automatically adding these penalties".

4. Whilst the User Guide is clear, the automatic nature of the obligation is less clear when reviewing the specific statements in both the EU Directive on Late Payment [19] and the Late Payment of Commercial Debts Regulations 2013. [20]

The EU Directive on Late Payment [21] sets out the automatic nature of the financial obligation in some detail:

Article 6 / Compensation for recovery costs

- Member States shall ensure that, where interest for late payment becomes payable in commercial transactions in accordance with Article 3 [Transactions between undertakings] or 4 [Transactions between undertakings and public authorities], the creditor is entitled to obtain from the debtor, as a minimum, a fixed sum of EUR 40.
- Member States shall ensure that the fixed sum referred to in paragraph 1 is payable without the necessity of a reminder and as compensation for the creditor's own recovery costs.
- The creditor shall, in addition to the fixed sum referred to in paragraph 1, be entitled to obtain reasonable compensation from the debtor for any recovery costs exceeding that fixed sum and incurred due to the debtor's late payment. This could include expenses incurred, inter alia, in instructing a lawyer or employing a debt collection agency. [22]

The Late Payment of Commercial Debts Regulations 2013 [23] (which amends the Late Payment of Commercial Debts (Interest) Act 1998) is also explicit in setting out the penalties for late payment.

Article 5A / Compensation arising out of late payment.

- Once statutory interest begins to run in relation to a qualifying debt, the supplier shall be entitled to a fixed sum (in addition to the statutory interest on the debt).
- That sum shall be–
  - for a debt less than £1,000, the sum of £40; .
  - for a debt of £1,000 or more, but less than £10,000, the sum of £70; .
  - for a debt of £10,000 or more, the sum of £100.

15. www.publications.parliament.uk/pa/bills/cbill/2014-2015/0011/15011.pdf

16. in Clause 3

17. www.gov.uk/government/uploads/system/uploads/attachment_data/file/336997/bis-14-928-public-sector-procurement-fact-sheets-revised.pdf

18. http://www.nao.org.uk/report/paying-government-suppliers-time-2/

19. http://ec.europa.eu/enterprise/policies/single-market-goods/fighting-late-payments/index_en.htm

20. http://www.legislation.gov.uk/uksi/2013/395/introduction/made

21. http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32011L0007&from=EN

22. ibid

- If the reasonable costs of the supplier in recovering the debt are not met by the fixed sum, the supplier shall also be entitled to a sum equivalent to the difference between the fixed sum and those costs.
- The obligation to pay a sum under this section in respect of a qualifying debt shall be treated as part of the term implied by section 1(1) in the contract creating the debt.
- Section 3(2)(b) of the Unfair Contract Terms Act 1977(2) (no reliance to be placed on certain contract terms) shall apply in cases where a contract term is not contained in written standard terms of the purchaser as well as in cases where the term is contained in such standard terms.
- In this section 'contract term' means a term of the contract relating to a sum due to the supplier under this section. [24]

23. www.legislation.gov.uk/uksi/2013/395/pdfs/uksi_20130395_en.pdf
24. ibid

Risks to public authorities

Regardless of the clarification on the automatic nature of the penalties, the underlying legislation remains a potentially significant financial risk to all public authorities and this issue will increase in focus as paid/should have paid disclosures are made.

By continuing to pay invoices past the 30 day deadline, public authorities are increasing their financial risk to this legislation.

As an example, a typical upper tier Authority might receive 150,000 invoices per annum and claim to pay 95% of them within 30 days (from date of receipt, not date they are logged into their system). They will, by implication, have 7,500 invoices which are paid late.

The fixed amount (late payment fee) would be a minimum of £300,000 and a maximum of £750,000.

Under the assumptions that (i) the average invoice value was £1,333 (c. £200m spend per annum) and (ii) that 'late' invoices were paid on average ten days late (i.e. paid on day 40) the estimated interest calculation would be:

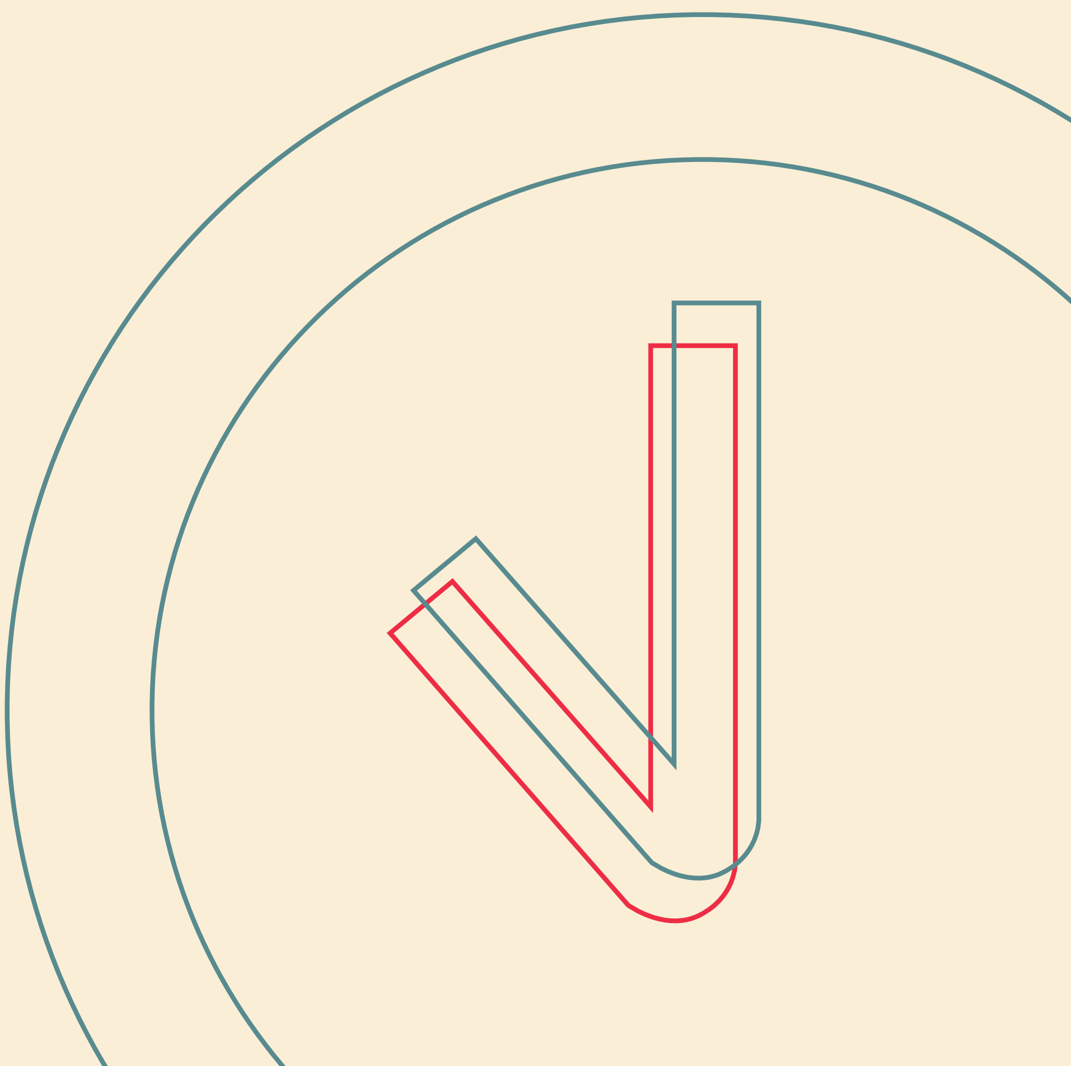
Suppliers can additionally claim compensation for reasonable costs in recovering the incurred debt.

Further important questions arise over how these liabilities will be recorded, whether they could be retrospective or indeed, would need to be carried from period to period.

[7,500 x £1,333 x [8.50%*] x (10/365)]=

£23,288

[* BoE base rate + 8.00%]



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