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 are very active in promoting and enforcing a 'responsible payment culture'.[1]

EXECUTIVE SUMMARY
o **The Government agrees that more can be done to ensure the public sector is an exemplar of good payment practices**
o **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**
o **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**
o **The need exists for Public Authorities to ensure 100% compliance with the 30 day payment standard**

[1] 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

- **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.[2]

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.'[3]

The United Kingdom Government's website[4] 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)'[5]

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.

- **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[6] to its December 2013 consultation paper *Building a Responsible Payment Culture*[7] 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[8] includes provisions[9] that would allow this to be put in place for larger companies.

In the public sector, reporting requirements are expected to be placed on public authorities via the regulations that implement the new European Directives on public procurement. There is currently a consultation on these regulations, including the requirement to report on late payment of invoices,[10], [11] . This consultation closes on 17th October 2014, and the

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2 www.gov.uk/government/uploads/system/uploads/attachment_data/file/360834/bis-14-1116-a-users-guide-to-the-recast-late-payment-directive.pdf
3 europa.eu/rapid/press-release_PRES-11-6_en.htm
4 www.gov.uk
5 www.gov.uk/late-commercial-payments-interest-debt-recovery
6 www.gov.uk/government/uploads/system/uploads/attachment_data/file/315462/bis-14-793-building-a-responsible-payment-culture-government-response.pdf
7 www.gov.uk/government/uploads/system/uploads/attachment_data/file/273436/bis-13-1234-building-a-responsible-payment-culture.pdf
8 www.publications.parliament.uk/pa/bills/cbill/2014-2015/0011/15011.pdf
9 in Clause 3
10 see regulation 112

Directive must be transposed into UK law by the 17th April 2016. However, the Government has made it clear it wishes to implement the transposition before that deadline.

- **The Department for Business, Innovation and Skills has stated it will undertake additional measures to strengthen the prompt payment code, establish 'best practice and fair payment terms' and increase prompt payment in the public sector.**

- **The Government is bringing forward legislation in the form of the Small Business, Enterprise and Employment Bill 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[12] on these initiatives.

- **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 included in the consultation document on the proposals for the transposition of the directive.[13]

- **The National Audit Office is currently conducting 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 are due to be published in late Autumn 2014.

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11 www.gov.uk/government/uploads/system/uploads/attachment_data/file/356494/Draft_Public_Contracts_Regulations_2015.pdf

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

13 see paragraph 53 of the consultation document and regulation 112 of the draft regulations

FACTS – FINANCIAL

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

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

- **There is no evidence of any Public Authorities that 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".

- **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[14] and the Late Payment of Commercial Debts Regulations 2013.[15]**

The EU Directive on Late Payment[16] 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

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14 http://ec.europa.eu/enterprise/policies/single-market-goods/fighting-late-payments/index_en.htm
15 http://www.legislation.gov.uk/uksi/2013/395/introduction/made
16 http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32011L0007&from=EN

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.'[17]

The Late Payment of Commercial Debts Regulations 2013[18] (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.

- 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.'[19]

- **The Government has committed to legislation which will ensure that 'all public bodies have to report on how well they pay their suppliers and what**

[17] ibid
[18] www.legislation.gov.uk/uksi/2013/395/pdfs/uksi_20130395_en.pdf
[19] ibid

interest they have paid, or should have paid, during the previous twelve months.'

This commitment is contained in the Government's response to the Communities and Local Government Select Committee's Sixth Report of Session 2013-14.

In practice, these requirements are expected to be enacted through the transposition of the new EU Procurement Directives in the Public Contracts Regulations 2015, as set out in the consultation document on the transposition.

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 day 40) the estimated interest calculation would be:

[7,500 x £1,333 x [8.50%*] x (10/365)] = £23,288 [* BoE base rate + 8.00%]

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?