National Audit Office

Report
by the Comptroller
and Auditor General

Cabinet Office and Department for Business, Innovation & Skills

Paying government suppliers on time

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Key facts

80%
percentage of undisputed invoices that departments aim to pay within 5 working days

4,000
number of small and medium-sized enterprises that ceased trading in 2008, citing late payment as the cause

£40bn
annual payments to suppliers by central government in 2012-13

4 million	electronic transactions paid by our 4 case study departments in 2013-14
520,000	paper invoices paid by our 4 case study departments in 2013-14
15 departments	who **reported** meeting the 5-working day target in 2013-14 for all transactions (of 17 main departments)
3 to 7 weeks	time taken by our 4 case study departments to pay 80% (by value) of paper invoices, commonly used by small and medium-sized enterprises
30 days	maximum time allowed for main contractors on government contracts to pay their subcontractors
0 of 4	number of departments we looked at that monitor their suppliers' compliance with contractual requirement to pay subcontractors within 30 days
20 of 44	number of central government's strategic suppliers that have signed the Prompt Payment Code

Summary

1 In March 2010 the government announced that departments would aim to pay 80% of undisputed invoices within 5 working days. This was a revision of the original prompt payment commitment introduced in 2008 to pay 90% of invoices within 10 working days. Government also announced that departments would require their contractors on all new contracts to pay subcontractors within 30 days. Prompt payment is intended to improve the cash flow of companies doing business with government departments, in particular the UK's 5 million small and medium-sized enterprises (SMEs).

2 The government believes a culture of late payment is preventing UK businesses, especially SMEs, from investing in growth and fully contributing to economic recovery. SMEs generate half of the annual turnover of UK businesses, but they often lack access to credit and may get into financial difficulties because of late payment by customers: a survey in 2014 suggested that late payment was a major factor in 1 in 5 UK corporate insolvencies.

3 Central government spends £40 billion a year on goods and services, of which about £4.5 billion is spent directly with SMEs. An additional £4 billion is spent with SMEs indirectly – where SMEs are subcontractors to government contracts.

4 The Cabinet Office has had responsibility since 2010 for the development and implementation of the prompt payment policy in the public sector and for government's procurement strategy. The Department for Business, Innovation & Skills (BIS) is responsible for overseeing prompt payment in the private sector and for encouraging the growth of SMEs.

5 This report examines:

- the case for the prompt payment commitment and whether the guidance and reporting requirements for departments are clear (Part One);
- government departments' reported performance against the 5-day target (Part Two);
- government action to ensure subcontractors benefit from the prompt payment policy (Part Three); and
- the role of Cabinet Office and BIS in supporting and monitoring the drive for prompt payment within government and the private sector (Part Four).

As part of our audit, we looked in detail at how 4 departments have implemented the prompt payment policy. These were: Ministry of Defence (MoD); Home Office; Department for Business, Innovation & Skills (BIS); and the Cabinet Office.

Limitation on scope

6 This report focuses mainly on implementation of the prompt payment policy by central government departments. We have also considered, to a more limited extent, government work in relation to prompt payment by the private sector. We have not examined the wider public sector (for example, local authorities and NHS trusts), which spends an additional £147 billion each year on goods and services.

Key findings

Prompt payment commitment

7 **UK business welcomes the government's commitment to pay 80% of undisputed invoices within 5 working days. This is significantly quicker than usual commercial payment terms of 30 days or more.** Business representatives told us that prompt payment by government helps businesses better manage their cash flow. It also helps tackle the culture of late payment by setting a positive example (paragraphs 1.2 to 1.12).

8 **Government has not been able to provide us with its estimates of the costs and benefits of the prompt payment commitment.** The commitment should lead to fewer business failures and reduce suppliers' costs, but BIS and the Cabinet Office were unable to locate the official papers setting out the policy's original objectives and its estimated costs and benefits. We estimate that if all departments paid all invoices in 5 working days, rather than taking the 30 days allowed by statute, this might benefit suppliers by reducing their interest costs by up to £88 million a year. However, we also estimate that paying suppliers early might lead to a one-off increase of up to £2.5 billion in government's working capital requirement. Assuming this is financed by an increase in national debt, we estimate this would cost government around £55 million a year in increased interest payments. Although our rough estimates suggest the commitment offers a net benefit, we have not quantified all costs and benefits so the net position is unknown (paragraphs 1.14 to 1.21).

9 **Government has not evaluated the prompt payment commitment to determine its effectiveness in helping small businesses.** SMEs tend to sit at lower levels of the supply chain and SMEs' representatives believe some large contractors hold on to cash paid promptly by government in order to boost their own working capital, rather than passing it down the supply chain. Despite this, government has not evaluated the impact of either the current or previous prompt payment commitment (paragraphs 1.17 to 1.18 and 3.5 to 3.8).

On departments' reported performance

10 **A lack of readily accessible guidance on what to report has led to variations in departments' reporting of their performance against the prompt payment target.** Guidance from 2010 requires departments to report their performance against the 5-day target both in their annual accounts and on their website, but this guidance is available only through an official 'archive' website. Most departments do report their performance in their annual reports, but every year a minority do not. For example, in 2013-14 only 14 of the 17 main departments reported their 5-day payment performance in their accounts. Two others published their performance on their website only. In addition to meeting the basic reporting requirement, some departments choose to publish other useful information. In 2013-14, for example, 8 departments reported their performance in paying suppliers within 30 days, and 7 reported the interest they paid on late payments (paragraphs 1.22 to 1.27).

11 **Departments are reporting good performance against the target, but headline performance in our 4 case study departments is skewed by a high volume of low-value electronic transactions with a few large suppliers.** Fifteen out of 17 departments reported that they met the target in 2013-14. In calculating performance, departments measure the volume rather than the value of invoices paid. Individual orders for low-value but high-volume items, such as train tickets and purchases made using a government procurement card, are each counted as a separate invoice; these goods and services are mainly provided by a small number of suppliers who invoice electronically. Except for the MoD, the departments we looked at have e-invoicing arrangements with only a small minority of their suppliers, yet e-invoices accounted for between 64% and 89% of their 2013-14 invoices. All 4 departments can achieve, or get close to achieving, the prompt payment target simply by paying their e-invoices promptly (paragraphs 2.2 to 2.3 and 2.7 to 2.10).

12 **Gaps in, and non-compliance with, central guidance means the 4 departments we examined have overstated their performance, and reported performance is not comparable between departments.** The 5-day target applies only to undisputed invoices, but 'disputed' is poorly defined. We found wide variation in the interpretation of this term and a lack of reliable data about the number of invoices excluded from reported performance. There is also inconsistency about when departments 'start the clock' for the 5-day period: some departments count only the days taken to pay once all approval processes are completed. Two of the 4 departments we looked at allow the operators of their shared service centres 6 working days to pay invoices, but count this performance as meeting the target (paragraphs 2.5 to 2.6 and 2.14 to 2.17).

13 **The 4 departments we looked at do not record the date they first receive paper invoices.** Suppliers have a statutory right to claim compensation if departments take longer than 30 calendar days to pay from the day of invoice receipt. The 4 departments we looked at record the date an invoice arrives at the team that pays invoices, but not when invoices are first received by the department. Such information is needed if compensation claims are to be swiftly concluded (paragraphs 2.16 to 2.23).

On the payment of SMEs and subcontractors

14 **SMEs report that although government pays more quickly than the private sector, the public sector still often pays late.** Three recent surveys indicate that SMEs are paid after more than 30 days approximately one-third of the time by their public sector clients. None of our 4 case study departments measures its own performance in paying SMEs. SMEs typically use paper invoices, and we found that it took the 4 departments we looked at between 3 and 7 weeks to pay 80% of the total value of their paper invoices in 2013-14 (paragraphs 2.2, and 2.18 to 2.19).

15 **In the absence of evidence that SMEs are benefiting from prompt payment by departments, we believe there is a risk that prompt payment mainly boosts the working capital of larger companies.** Only 11% of government procurement spend is directly with SMEs. Many SMEs do business with government as a subcontractor to larger companies above them in the supply chain. Although the 4 departments we looked at have all included a standard clause in their contracts requiring main contractors to pay their subcontractors within 30 days, none of the departments monitors whether their contractors are complying. This means companies at the top of government supply chains should receive payment within 5 working days but there is little pressure for them to release that cash to pay their own suppliers on time. Our 4 case study departments lack information about who their subcontractors are or whether they are being paid on time by the main contractors (paragraphs 1.8, and 3.2 to 3.8).

16 **There is little evidence that wider initiatives aimed at improving prompt payment of suppliers and subcontractors have had significant impact on payment performance in public sector supply chains.** Although companies that have signed the voluntary Prompt Payment Code tend to pay their suppliers more promptly, fewer than half of the government's most important suppliers have so far signed the Code. The Code lacks guidance on what constitutes fair payment terms, and there are no effective sanctions if a signatory does not comply with it. Although the evidence is limited, there are some indications that the Cabinet Office's Mystery Shopper Service, which investigates complaints from government suppliers while protecting their identity, has a low profile among subcontractors, and those who have heard of it fear that making a report will lead to a loss of business. Government has not evaluated the effectiveness of project bank accounts, a payment mechanism that enables government to pay subcontractors at the same time as the main contractor (paragraphs 3.9 to 3.17).

Role of the centre of government

17 **The Cabinet Office, representing the centre of government, has shown little strategic leadership on prompt payment in the public sector, until recently.** Although guidance on performance measurement and reporting exists, the guidance is not readily accessible, which is leading to inconsistent reporting by departments. The Cabinet Office has not monitored departments' compliance with the guidance, nor has it identified or shared with departments good practice in the processing of invoices. Furthermore, it has not actively encouraged prompt payment reporting by the wider public sector (paragraphs 1.16 to 1.18, 1.26 to 1.27, 2.6 and 4.2 to 4.8).

18 The Cabinet Office and BIS are currently reviewing the prompt payment policy for the public and private sectors. Alongside the Small Business, Enterprise and Employment Bill currently under consideration by Parliament, associated secondary legislation contains measures recommended by Lord Young, the Prime Minister's Special Advisor on Enterprise, intended to improve prompt payment by the public and private sectors. The Cabinet Office told us the measures will clarify responsibilities for monitoring prompt payment in the wider public sector. BIS is consulting on a requirement for large companies to report their payment practice. The Cabinet Office also plans to reissue the guidance for departments on reporting prompt payment performance and to monitor departments' compliance with the new guidance (paragraphs 4.5 to 4.7).

19 Limited progress has been made in introducing electronic invoicing. Electronic invoicing can reduce processing times and costs for both suppliers and customers. In 2010 the government said departments would explore the use of electronic invoicing for all suppliers. Although the 4 departments we looked at use electronic invoicing with some high-volume/low-value suppliers, none of them routinely allow small suppliers to submit e-invoices. Secondary legislation is under development which will make the acceptance of e-invoices by public bodies mandatory in due course (paragraphs 2.13, 4.6 and 4.9 to 4.12).

Conclusion on value for money

20 UK business welcomes the government's commitment to pay 80% of undisputed invoices within 5 working days. However, there is little evidence that the commitment is having the intended effect of helping SMEs. There is a risk that the main effect is to boost the working capital of main contractors rather than benefiting other businesses in the rest of the supply chain.

21 Almost all departments have publicly reported good performance against the target, which covers £40 billion of government annual procurement spend. However, government's method of measuring performance is flawed and is not adhered to by the 4 departments we looked at, meaning that their reported performance is overstated. Very large numbers of electronic invoices from a few suppliers, and delays in 'starting the clock', mean these departments can meet the target even while most suppliers, including SMEs, are receiving a significantly lower standard of performance than is being reported. We conclude that the Cabinet Office cannot demonstrate that the implementation of the prompt payment commitment is achieving its intended purpose and therefore providing value for money.

Recommendations

22 The Cabinet Office should strengthen its strategic leadership of public sector prompt payment:

a Set out the **principal objectives** of the 5-day payment commitment and its estimated costs and benefits.

b Revise the **guidance on the measurement and reporting** of prompt payment performance to:

- count the days taken to pay an invoice from the date the invoice is first received by the department, to bring UK practice into line with EU legislation;
- provide a clearer definition of a disputed invoice;
- require public sector bodies to extend their reporting to include the value of invoices paid within the target period, the number of disputed invoices, performance in paying in 30 days, and interest and penalties paid; and
- ensure that all public sector bodies report performance in a consistent location.

c Seek assurance that departments and other public bodies are **complying with the updated guidance**.

d Actively identify and disseminate **good practice** in prompt payment across government and the wider public sector.

e Develope a **strategy to encourage** the wider public sector to pay their suppliers promptly and report their performance in doing so.

23 BIS and the Cabinet Office should:

f Assess the best way to extend **the use of e-invoicing**, bearing in mind its costs and benefits to government and to suppliers.

g Better **promote the existing initiatives** intended to ensure subcontractors are paid on time: the use of project bank accounts, the Prompt Payment Code and the Mystery Shopper Service.

24 Government departments should:

h Comply fully with **performance measurement and reporting requirements** set by the centre of government.

i Ensure the **date invoices are first received** is accurately recorded.

j Monitor **compliance by key contractors** in paying subcontractors within 30 days.