Reporting on payment practices

Using the legislation to improve your cash flow

Introduction

As part of the Government's continuing efforts to improve payment practices and increase transparency, the UK's largest companies and limited liability partnerships (LLPs) will now have to report twice a year on payment metrics, including the average time taken to pay supplier invoices.

Late payment is a key issue for small and medium sized businesses as it can affect their cash flow and their ability to trade. The Spring 2017 edition of the Bank of Scotland Working Capital Index highlighted that almost one in four of the companies surveyed noted that customers took longer to pay in the last 12 months.

It is hoped this new reporting requirement, implemented in April 2017, will encourage businesses to adopt timely payment practices.

In order to prepare for these submissions, large businesses and LLPs will need to review how quickly each invoice has been paid and compare this to agreed contractual terms. This will provide insight into the business' underlying payment and procurement processes that could lead to improvements to their cash flow.

This factsheet outlines what in scope businesses should do now and how the information can be used to drive improvements in cash flow and, in time, develop greater insight into industry peers and customers.

Who will the new legislation apply to?

The duty to report applies to UK registered large businesses and limited liability partnerships that meet or exceed two or more of the criteria below on both of their last two balance sheet dates:

- Over £36 million annual turnover;
- Over £18 million balance sheet total;
- Over 250 employees.

It will apply regardless of whether the business is public or private. Each business in scope will be required to publish its own individual reports. A group of companies, therefore, may be required to publish a report for each group company that satisfies the criteria; there is no provision for consolidated group reporting. Where a business has one or more subsidiaries, a slightly different set of thresholds apply:

- Over £43.2 million annual turnover or £36 million net of group transactions;
- Over £21.6 million balance sheet total or £18 million net of group transactions;
- Over 250 employees.

Businesses will be required to publish information about their payment practices and policies connected to contracts that have a significant connection with the UK (e.g. either goods delivered or services carried out in the UK or where the supplier is established in the UK). Payments relating to contracts between businesses and consumers and contracts for financial services are *not* covered by the reporting requirement. A company director or, in the case of partnerships, a designated person, will be required to approve the information before publication. Failure to do so, or providing false or misleading information, would constitute a criminal offence which may include a fine for the business or individual.

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What needs to be reported

Report timing	▸ Twice yearly, relating to the 1st and 2nd six month periods of the financial year ▸ Reports will be due within 30 days of the end of each reporting period
Narrative reports	▸ Standard payment terms, including the payment period or the most frequently used if it does not have a standard ▸ Maximum payment period agreed with any supplier ▸ Any changes to standard payment terms during the reporting period and whether suppliers had been notified or consulted in advance ▸ Description of its processes for resolving payment related disputes (the aim is to help suppliers understand what they must do)
Statistics	▸ Average number of days taken to pay invoices (from the date of receipt of invoice) ▸ Percentage of payments made within 30, between 31 to 60 and over 60 days ▸ Proportion of payments paid after agreed terms
Yes/No statements	▸ Whether suppliers are offered e-invoicing ▸ Whether supply chain finance is available ▸ Whether there is a charge for remaining on a supplier list ▸ Whether the business is member of a payment code
Non-compliance	▸ Both the company and its directors will be liable for a fine for failure to report or for publishing false or misleading information

What should affected businesses do now?

Whilst the official guidance includes information to help businesses decide whether they fall in scope and how to calculate the various statistics, there are a number of areas that businesses should start to review in order to prepare for their first submission.

Review arrangements where **no written contract exists** or where it is unclear on whose terms the parties trade to ensure the agreed payment date is captured;

For **transactions where an invoice is not used**, ensure systems are in place to capture the date when the business has received notice of an amount to be paid;

Review finance systems to ensure that **processes are in place to gather the data** needed to submit a report. In particular, businesses should review how and where invoices are received across the business to ensure the date the invoice is received can be captured accurately and consistently;

Consider **whether the performance of the business against the required metrics is reasonable** and the likelihood of any reputational issues which may result from their treatment of suppliers. Where performance may be considered as sub-standard, businesses should consider whether any narrative can be included in the report to add context;

Where supply chain finance is offered and the supplier does not receive the full amount owing due to the payment of a fee or other deduction, the business needs to capture the date on which the payment is made to the finance provider as the date of payment.

Using the information to drive improvements in working capital

In preparing the half-yearly submissions, each business will undertake a series of calculations determining how quickly invoices are paid. Comparing these calculations to standard and contractual terms will provide further insight into the underlying procurement and payment processes that could lead to cash flow improvements:

- **Contract compliance:** Review supplier agreements and purchase contracts to ensure supplier payment terms are recorded accurately in finance systems. Compare the average time taken to pay supplier invoices to contractual payment terms and those recorded in the vendor master file for the business' largest suppliers. This should help to ensure early payments are avoided and made on time.

- **Invoice size:** The data will show the distribution of invoice sizes paid by the business in each period. Where there is a high volume of low value invoices, efficiency could be increased by negotiating with suppliers to provide consolidated invoices or introducing purchasing channels, including purchasing cards. The latter could also lead to a cash flow improvement from longer credit terms.

- **Payment timing:** Procurement and payment processes could be strengthened by investigating a sample of early and late payments. This could include:

  – Centralising where invoices are received;
  – Improving contracting or procurement processes to include payment terms;
  – Assessing dispute resolution processes to ensure they are effective and include clear responsibilities and accountabilities; and
  – Amending supplier communication to clarify what information is required in order to ensure a valid invoice is paid.

- **Payment frequency:** To improve payment transparency, businesses should include details of the timing of supplier payments as well as the number of days in agreed payment terms. Where this is not the case currently, businesses may report late payments where invoices fall due for payment between agreed payment runs. Payment data used for reporting purposes will also indicate how frequently supplier payment runs are made. Businesses should take care to understand and manage the impact, in terms of price, service and risk, of reducing the frequency of payment runs on suppliers; balancing this against any improvements in cash flow the process change generates.

- **Payment terms:** The invoice payment calculations will highlight whether suppliers have a range of payment terms that could be harmonised. In addition, where businesses have suppliers that are also customers, comparing the length of payment terms to when the supplier pays sales invoices will highlight opportunities to harmonise business dealings.

- **Payment clock:** As the payment timing calculations are based on the date the supplier invoice is received, comparing this date to the invoice date will identify whether a cash flow benefit could be created by changing the start date of payment terms to the later of these two dates (typically the invoice received date is after the invoice date). This might require businesses to amend standard procurement terms and underlying finance systems to ensure the correct date is used to calculate payment due dates.

How can the reported information be used?

Company submissions will be made available to the public once they have been submitted. In time, as more and more businesses complete their first six month reporting period, a body of data will be available that will enable businesses to generate a picture of their competitive landscapes and supply chains that can be used within trading negotiations:

- **Industry peers:** In time, businesses will be able to benchmark their terms against their peers across both products and markets where there is more than one standard term;

- **Customer insight:** Businesses will be able to use the data to understand how quickly their customers pay their suppliers. Where this payment performance and term information is very different to the agreed contract terms, this could help businesses renegotiate shorter payment terms.

Next steps

With continued pressure on cash cycles now is certainly the time for British companies to renew focus on working capital. We have focussed our business banking teams on this need and developed a set of tools to help businesses analyse their own working capital position and suggest ways to improve it. The path to greater working capital efficiency can start today with a conversation with a Bank of Scotland Relationship Manager.

The guidance to reporting on payment practices and performance is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587465/payment-practices-performance-reporting-requirements.pdf

The Bank of Scotland Working Capital Index is available at:

www.bankofscotland.co.uk/workingcapital

Contact us

Should you have any queries relating to working capital and improving cash flow in your business, you can contact us by:

Please contact your Relationship Manager to discuss your needs

Go to bankofscotland.com/commercialbanking