DUTY TO REPORT ON PAYMENT PRACTICES AND PERFORMANCE IN THE U.K.

WHAT BUSINESSES NEED TO KNOW ABOUT THE NEW LEGISLATION – JANUARY 2018

ALVAREZ & MARSAL

Summary

Businesses with registered U.K. companies and LLPs are now required to report on payment practices and performance metrics for financial years beginning after 6 April 2017. Excessive payment terms and late payments can be serious issues for companies, impacting cash flow and sometimes limiting a firm's ability to operate effectively. In worst-case scenarios, late payments can lead to going concern pressures and even insolvency. The "Duty to Report on Payment Practices and Performance" aims to reduce this risk by improving transparency of payment performance amongst U.K. businesses, particularly with regard to small-to-medium enterprises (SMEs).

It is the most stringent action taken by the U.K. to date to address the issue, and it follows a series of voluntary codes, directives and consultations, most notably the "Prompt Payment Code". Working capital management is becoming ever more sophisticated, and the push for a sustainable cash culture throughout Europe is strong. Official legislation was inevitable, and as the cost of capital potentially rises, so will scrutiny around payment practices and consequences for poor performance.

Under the new legislation, U.K. businesses that meet at least two of the following thresholds are required to report their payment practices bi-annually:

Annual turnover of £36 million or more

Balance sheet total of £18 million or more

250+ employees

Failure to comply is a criminal offense. Therefore, affected businesses should take immediate action to understand these new requirements, ensure compliance and maximise resultant opportunities that may arise from newly available public data.

This article details:

- Reporting Requirements
- Steps to Ensure Compliance
- Opportunities to Improve Performance

Reporting requirements

Under the new legislation, companies and LLPs registered in the U.K., including foreign-owned entities, that meet at least two of the three thresholds outlined in the summary of this document (p. 2) must report a series of statistics, narrative descriptions and statements (Exhibit 1) in the first and second half of their financial years, factoring in all qualifying contracts.

The requirements apply to all qualifying entities within a Group – i.e., there is no option to consolidate reporting, and details will be required for each individual entity that meets the threshold measures.

Qualifying contracts are between two or more firms for the exchange of goods, services or intellectual property with a sufficient link to the U.K. They can be written, verbal or a combination of both. Non-U.K. suppliers can be qualifying contracts, and intercompany transactions are also in scope. In fact, most contracts will be qualifying with the exception of most financial services and contracts governed by non-U.K. law.

Payment practices and performance reports must be submitted through an online portal within 30 days of the end of each six-month period (e.g., the first or second half of the firm's financial year) for all financial years beginning on or after 6 April 2017. At the earliest, some firms will have been required to report in October 2017, but for most this will begin in 2018.

Exhibit 1 – Payment practices and performance reporting requirements

Statistics	Narrative	Statements
■ Average number of days to make payments in reporting period ■ Percentage of payments (by volume) made within: - <31 days - 31-60 days - >60 days ■ Percentage of payments not made within the agreed payment period	■ Standard payment terms: - Standard contractual time for payments - Maximum contractual payment period - Notification process for changes to standard term. ■ Standard dispute resolution process	■ Are suppliers offered e-invoicing? ■ Is supply chain finance available? ■ Are there charges for remaining on supplier lists, and if so has this been done in the reporting period? ■ Is the business a member of a payment code, and if so, which code?

Information source: Duty to Report on Payment Practices and Performance Guidance - U.K. Department for Business, Energy and Industrial Strategy.

While a comprehensive list of frequently asked questions can be found in the guidance published by the U.K. Department for Business, Energy and Industrial Strategy, below are a number of questions that Alvarez & Marsal (A&M) has highlighted as being particularly relevant, and that could easily be overlooked by firms still becoming familiar with the new legislation:

1 What does "receipt of invoice" mean?

"Receipt of invoice" refers to the date a business physically receives an invoice, whether by post or email. It does not refer to the date the invoice was sent, the invoice date, the tax point or the date of receipt for goods or services. The new legislation requires businesses to base payment performance on the "receipt of invoice" date. This is important to understand because "receipt of invoice" is not typically a standard data field for businesses and will potentially require a process change to ensure this data is being captured.

2 How do you handle reporting without an invoice?

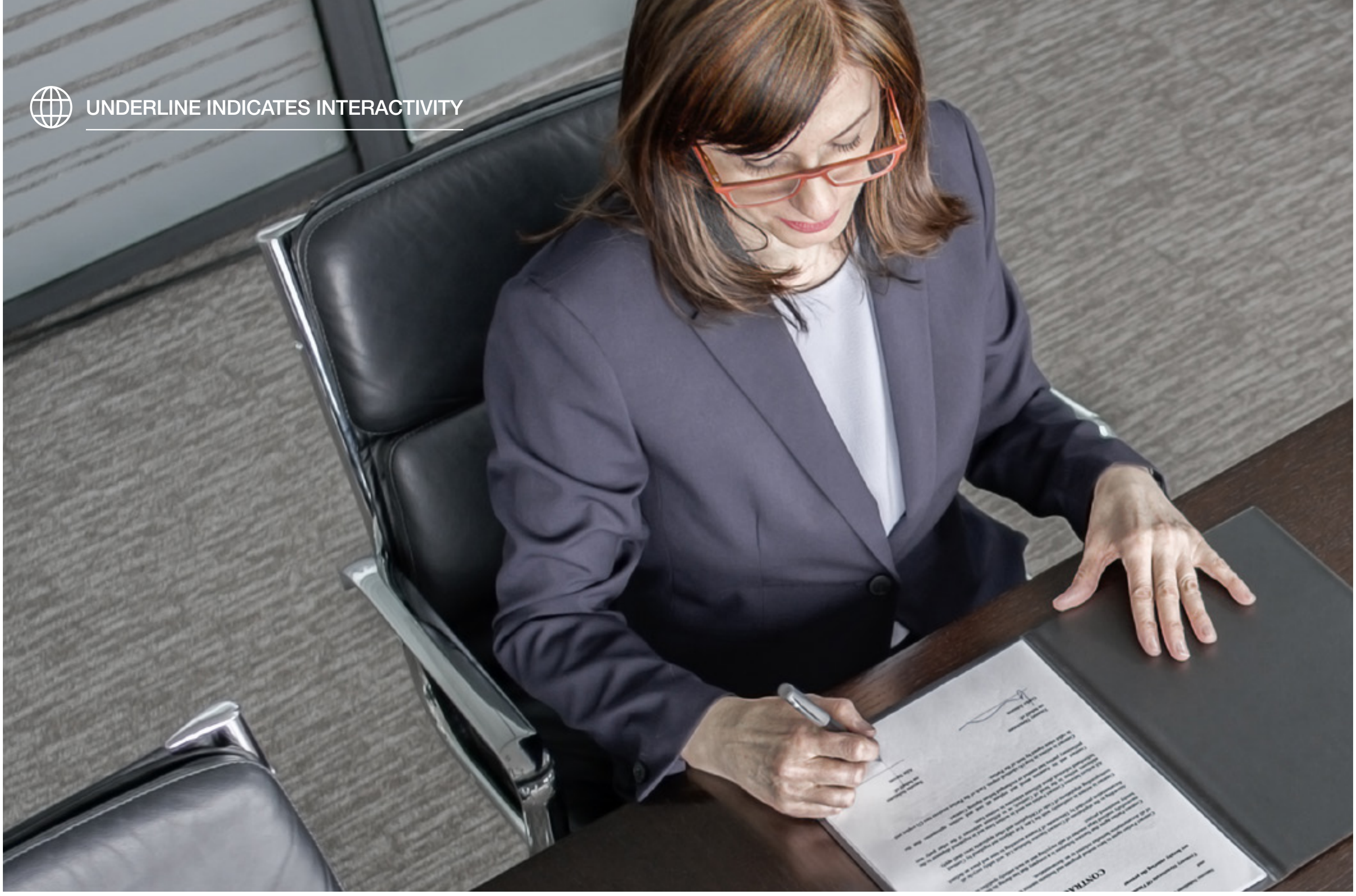
Payments can also be triggered by the receipt of a timesheet for work delivered or by the customer notifying the supplier of its intent to make a payment under the terms of a contract. In these cases, payment performance should be based on the date immediately after the payment amount is confirmed – either by the timesheet or by the supplier's response to the customer's notification.

3 Can I use weighted averages for my calculations?

No, the legislation specifically requires that averages use the volume – not the value – of transactions. This is intended to ensure that statistics give equal weighting to suppliers regardless of their transaction size. In other words, it reduces the likelihood that payment performance with SMEs is "hidden" or distorted by the performance of larger suppliers.

4 What is the impact of supply chain finance?

Businesses are required to state whether their policies and practices include the use of an external supply chain finance provider. If they do, in the event a supplier receives full payment on time without incurring a fee or reduction, the date of deposit is recorded as the payment date. If the supplier incurs a fee or reduction to receive earlier payment, the payment date is recorded in line with the standard term (i.e., as if the payment was not accelerated).



Steps to ensure compliance

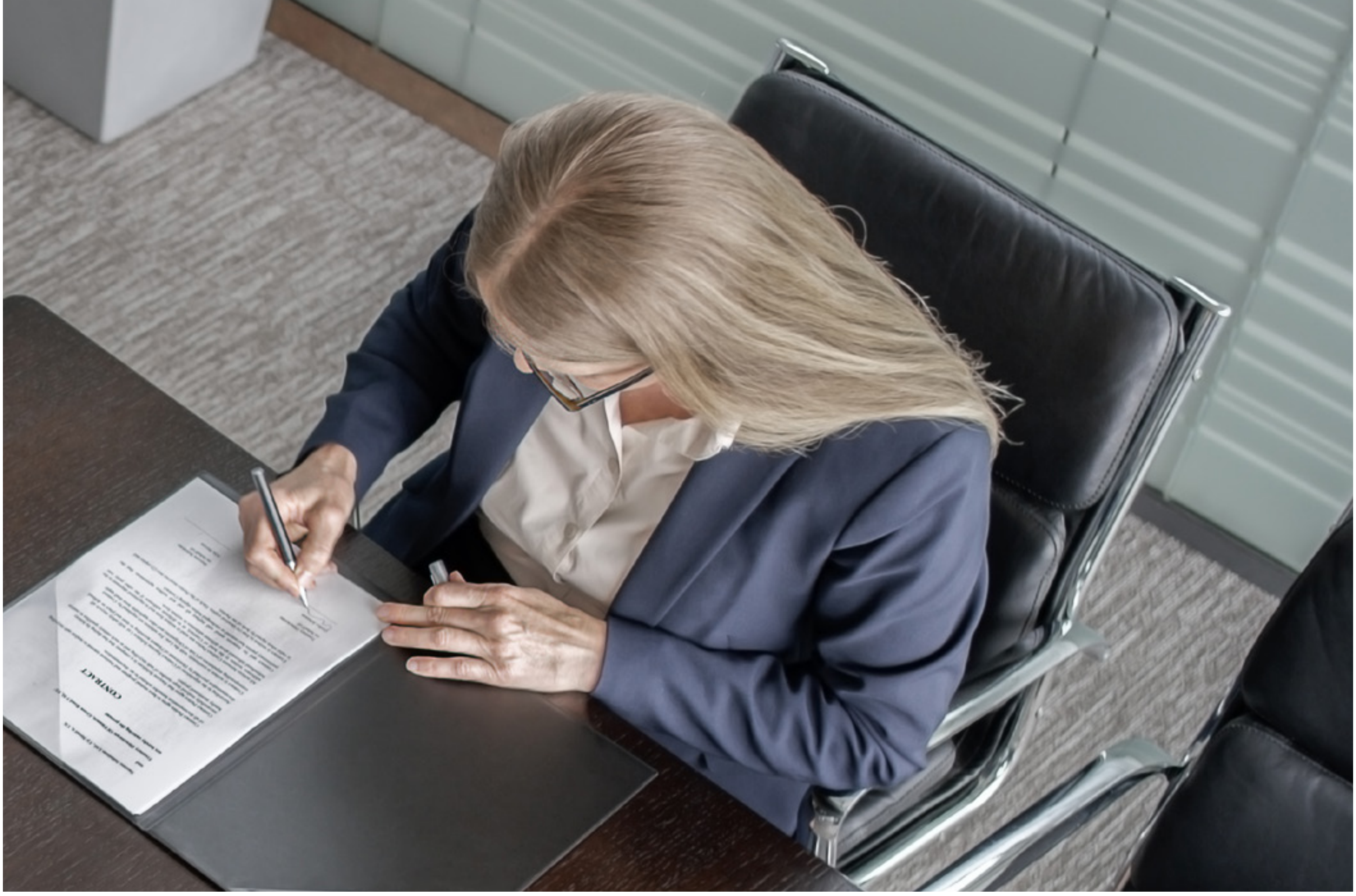
Failure to comply with this new legislation is a criminal offense, so businesses must take immediate action to ensure they are prepared to respond. To ensure compliance, businesses should take the following steps:

1 Understand the new legislation and how it applies to your business.

Refer to the "Duty to Report on Payment Practices and Performance" for detailed guidance published by the U.K. Department for Business, Energy and Industrial Strategy. In just 30 pages it comprehensively covers the legislation. Review the size threshold criteria and ensure you understand which entities in your business are required to report.

2 Know which of your suppliers are in scope.

Refer to pages 12-13 of the guidance, and review your complete list of suppliers to identify which contracts qualify and must be factored into your payment reporting. There are very few exemptions, but they could significantly impact your analysis if treated incorrectly.



3 Ensure you can systematically capture all required information.

You will need to compile the statistics, narrative descriptions and statements outlined in Exhibit 1 of this document. Narrative descriptions and statements primarily reflect a business's standard policies and procedures, therefore, they may not change frequently. Conversely, the statistics will require ongoing collection of data and will change every reporting period. Make sure you fully understand how statistics must be measured and that you capture the data accordingly. As noted above, payment dates should be based on "receipt of invoice," which is often not a standard data field for businesses. You may need to start tracking data points you have not captured in the past. Once you have a clear sense of what information needs to be captured and how frequently inputs will change, you will need to establish a systematic process for collecting, analysing and reporting information in perpetuity.

4 Have technology in place to improve the efficiency of reporting.

While compiling your first report will likely be a manual process in part, you will want to make this a seamless part of your standard reporting going forward. If you do not have appropriate analytical technology in place already for this level of reporting requirement, or if your existing technology cannot be modified to do so, begin looking for systems that can automate data collection, analysis and reporting moving forward – in all likelihood this technology will have wider applicability to your business and will help drive improved cash visibility and performance.

Opportunities to improve performance

While new reporting requirements may be a challenge initially, these legislative changes can create new opportunities for working capital performance down the road.

In addition to creating better internal benchmarking measures through new data collection and more detailed reporting, the publicly available data generated from other businesses across industries will improve visibility of how others are performing. This will likely present opportunities for businesses to ensure they are aligned with peers and, if they are not, to ensure they are taking the appropriate steps to improve performance accordingly.

As businesses, both large and small, look more closely at their payment performance in response to this legislation, it is important to note there is much more to working capital than just payment terms and associated payment performance. Reflecting on our extensive experience in this area, organisations that effectively manage working capital typically have the following key attributes:

A robust "cash culture"

Appropriate cash cultures focus on the visibility, control and accountability of cash and working capital to complement other business priorities. All individuals within the organisation understand their roles relative to working capital performance, and this is embedded within their day-to-day activities. Working capital performance is seen as being integral to overall corporate performance, not mutually exclusive with wider P&L outcomes.

Reliance on facts, versus anecdote

Real-time transactional data informs KPIs and the overall measure of working capital effectiveness. This transactional insight drives performance with an ever-evolving focus on specific initiatives to drive liquidity.

Adaptability, allowing for sustainable change

Successful working capital management is driven by sustainable, non-tactical initiatives to adapt and allow for change throughout the year, thereby avoiding a frantic "dash for cash" at the year end.

Technology-enabled continuous improvement

Technology does not only streamline data collection, analysis and reporting, it can also help to assess performance in real time on an ongoing basis, making improvements faster and more effective. The ability to drill down into underlying performance enables targeted improvement and the ability to properly track initiatives.

How A&M can help

As businesses prepare to meet these new requirements, those that seize the opportunity to optimise their payment performance and improve overall working capital efficiency may turn a temporary inconvenience into a valuable, longer-term opportunity. A&M is ready to help you on that journey. Our dedicated Cash and Working Capital team has extensive experience helping businesses to define, plan and implement sustainable working capital improvement.

Ensure you comply.
Optimise your processes.
Maximise your opportunity.

Contact A&M to get started

Sources

Duty to Report on Payment Practices and Performance Guidance – U.K. Department for Business, Energy and Industrial Strategy, 2017.

Related A&M insights

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This article was produced with research and support from the A&M Insight Center, which serves to provide A&M professionals and clients with relevant, industry-specific, actionable insights derived through proprietary studies and research.

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Mr. Tatham brings more than 18 years of experience working with management teams to identify, plan and implement performance improvement opportunities. His primary areas of specialism are working capital and cash optimisation, transformation and turnaround planning, operational governance and operational due diligence. Mr. Tatham has worked with clients across a wide range of industries including retail, fast-moving consumer goods (FMCG), energy, healthcare and telecommunications.

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Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to make change and achieve results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services.

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