Implementation of Project Bank Accounts across Highways England

Abstract

Across the construction industry it has not been unusual for lower tiers of the supply chain to wait up to 100 days to receive payment. Such inefficient payment practices damage supply chain cash flow and results in additional financing requirements that the client has to ultimately pay. In 2009 the Government Construction Board decided to introduce Project Bank Accounts (PBAs) as a means to address these concerns unless there are compelling reasons not to do so. PBAs are designed to ensure security and certainty of payment to the supply chain down to Tier 3 level and involve making payments through a specific ring fenced bank account set up for a particular scheme. They also ensure speed of payment and drive efficiencies that can be passed onto the client as a result of reduced financing requirements. The paper discusses the reasons for introducing PBAs across Highways England schemes and the benefits they have brought to both the client and supply chain.

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1. Introduction

Security of payment across the supply chain in the construction sector has been a long standing issue. In 1994 Sir Michael Latham published 'Constructing the Team' which recognised that the typical mechanism of a client making payment to main contractor, main contractor to sub-contractor and so on down the chain resulted in payments being made to the lower tiers up to 3 months after work had taken place. If any part of the supply chain became insolvent then subsequent tiers would be treated as unsecured creditors and potentially only receive a fraction of monies due for the work performed. Some of the impact could be mitigated through bad debt insurance, but such overheads impacted the ability to provide competitive quotes and ultimately additional costs are passed onto the lead client.

One of Sir Michael Latham's recommendations to address the issue of insolvency was to set up trust accounts for interim payments. In the event of the main contractor failing, the supply chain would be afforded a degree of protection for work they had already performed. Whilst recognising the possibility of the lead client setting up a trust and making payment directly to the lower tiers, Sir Michael stopped short of making this a recommendation. The report had a significant impact upon the industry, leading to the Construction & Regeneration Act 1996 prohibiting 'pay when paid' clauses, however it could be argued that only a limited step forward was made in relation to fair payment practices.

In 1998 Sir John Egan published 'Rethinking Construction' that advocated stronger relationships with the supply chain and in the same year the Late Payment of Commercial Debts (Interest) Act 1998 was passed that allowed a supplier to claim interest on late payments. Whilst the standard timeframe of 30 days was applied, terms longer than 60 days could be agreed as long as it 'was fair to both businesses'. The reality was that it had a limited positive effect on the construction industry as suppliers were reluctant to hold higher tiers of the supply chain to account.

In 2008 a report entitled 'Never Waste a Good Crisis, A Review of Progress Since Rethinking Construction and Thoughts to our Future' (Wolstenholme, 2008) determined that elongated payment cycles continued to be endemic and the practice of 'subbie-bashing' through re-tendering contracts was happening. Such practices often occurred due to the purchasing power of the higher tiers of the supply chain, combined with the reluctance of the lower tiers to publically call into question adverse payment practices.

A year earlier the Office of Government Commerce (OGC) published its Guide to Best 'Fair Payment' Practices (OGC, 2007) that set out a 'Fair Payment Charter' which attempted to begin to address some of the continued poor payment practices that was prevalent in the industry. The charter committed government construction contracts to have payment terms that did not exceed 30 days. The same report also recommended that public sector clients should consider using Project Bank Accounts (PBA) where it was practicable and cost effective to do so.

In late 2009 the Government Construction Board determined that all public bodies would adopt PBAs on future contracts 'unless there are compelling reasons not to do so'. The 2011 Government Construction

Strategy (Cabinet Office, 2011) reaffirmed this commitment and led to the Cabinet Office publishing its implementation strategy in 2012 (Cabinet Office, 2012a; Cabinet Office 2012b).

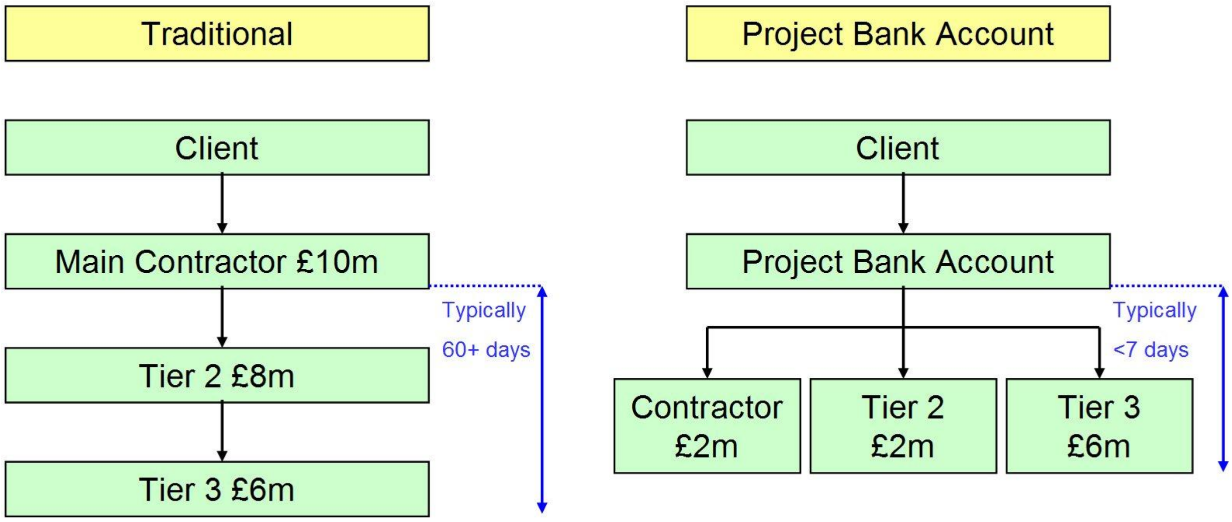
Evidence to show the limited progress made since Sir Michael Latham's 1994 report 'Constructing the Team' is perhaps affirmed by the results from the National Specialist Contractors Council 2014 Payment Survey that showed only 57% of their members receive payment within 45 days and 56% of members receive payment within 30 days when contracting with a government client. Such views are reinforced in the Department for Business Innovation and Skills 2013 BIS Research Paper No. 145 which stated that the common view amongst sub-contractors was that payment terms were worsening and some had to increase prices between 3-4% to fund the extended payment timeframe.

The government set out a target in 2012 (Cabinet Office, 2012a) to deliver £4bn worth of construction projects using PBAs over the following three years. Within this target, Highways England was tasked to deliver £3.7bn due to the number of contracts likely to be let during the three year period. Highways England is a publically owned corporation created in April 2015 that is responsible for managing the Strategic Road Network in England. Prior to 2015 this role was undertaken by Highways Agency which was an Executive Agency of the Department for Transport. The network is responsible for some 4,300 miles of road and carries 34% of all road travel and 67% of freight travel. In December 2014 the government published the Roads Investment Strategy which will see £15.2bn invested over a 5 year period.

2. What is a Project Bank Account?

A Project Bank Account is a ring fenced bank account set up specifically for a scheme or framework which is placed into funds by the client in the normal way when a payment is due. Payments are then made from the account directly and simultaneously to the supply chain down to Tier 3 level (See Figure 1.). There are two types of account in operation known as the Single Authority or Dual Authority approaches. Under the former, the lead contractor (referred to as the Tier 1) is the sole trustee of the account, whilst under the latter both the client and lead contractor are trustees. Both approaches are fundamentally the same although under the Dual Authority approach both the client and lead contractor have to authorise payments to the supply chain. After careful consideration Highways England chose the Single Authority approach using the NEC3 ECC Option Y clauses (NEC, 2013). This option was preferred as it was felt that sufficient challenge was being undertaken as part of the monthly / stage assessments prior to the PBA being funded and it was therefore unnecessary to be a signatory to any outgoing payments made by the Tier 1 to subsequent tiers of the supply chain. However, the backup to the assessment provided by the Tier 1 contractor was amended to include information about the intended payments to the supply chain.

Figure 1. – Flow of funds from client to supply chain.



There were clear guidelines set by the Government Construction Board about what features the bank account must contain (Cabinet Office, 2012b). One of the main features was that the bank account must be linked to a Trust Deed so that the money is ring fenced. Any Tier 2 or 3 suppliers wishing to be party to the PBA are required to sign a Joining Deed which affords them protection in the event of lead contractor insolvency. The bank account is not allowed to have any overdraft facility and all payments must be made by either BACS or CHAPS. Finally, the bank is required to confirm that all monies are held in trust and they cannot be used to offset any other contractor liabilities. As Highways England decided to follow a Single Authority model the choice of bank was left up to the lead contractor to decide. In practice most contractors used the same bank where they already had a pre-existing commercial relationship. To ensure the account had been set up correctly all Highways England required was a simple confirmation directly from the bank that the account in operation contained the features as set out by the Government Construction Board. In earlier contracts, the number of banks offering a PBA compliant product was very limited but today most major banks offer PBAs including a number of smaller providers who are keen to get a foothold in the UK market. On earlier contracts Highways England was given direct view only access to the banking portal that the contractor used. However, it quickly became apparent that with the number of banks offering PBA compliant products increasing, it was easier to confirm compliance through a simple download of a pdf bank statement that the contractor supplied.

Highways England set a number of challenging targets when introducing PBAs across its contracts. Before the implementation of PBAs, Highways England had up to 28 days from the date of the assessment to make the outgoing payment to the Tier 1 lead contractor. Whilst in practice payments were often made substantially quicker than this (99.6% within terms and 94% within 5 days), it has been a well-publicised issue within the industry that payments flow down to the lower levels of the supply chain up to 120 days later. As a result Highways England set a challenging target of the PBA being placed in funds within 14 calendar days of the assessment date (including 2 working days for payment to clear in the PBA) and subsequent payment to be made simultaneously to all levels of the supply chain that had joined the PBA within a further 7 days. As a result, all suppliers down to Tier 3 level that had signed up to the PBA would be paid within 21 calendar days of the assessment date.

In total, 3 ambitious targets were used to measure how effectively the Tier 1 lead contractor was managing the PBA:

- A minimum of 80% by value of Tier 2 and Tier 3 contractors to join the PBA
- Management information evidencing payments being made within agreed timeframe
- Payments to be made to Tier 2 / 3 within 7 days on average

These targets were used as part of Highways England performance metrics of Tier 1 contractors and were used to inform future contract awards. To incentivise lead contractors to go beyond the minimum, additional points could be scored if more of the supply chain were signed up to the PBA and payments made earlier than the 7 day target. If the minimum targets were not met then this would negatively inform future contract awards.

3. Advantages of Project Bank Accounts

Research undertaken by the Office of Government Commerce suggested that savings in the region of 1% - 2.5% could be achieved through introduction of a PBA (Office of Government Commerce, 2007). These savings are realised through Tier 2 and Tier 3 supplies passing on part of the saving made through reduced finance requirements, a guarantee of surety of payment, reduced debt chasing and administration. Some of the saving is negated by the Tier 1 losing the treasury function it once had by holding onto funds for a lengthy period. Although Highways England have been using PBAs since 2012 it is difficult to verify the savings passed onto the client without running parallel competitions, one with a PBA clause and one without. Anecdotal evidence suggests that the net savings are circa. 1% but this still provides a significant saving to the tax payer in the context of the Roads Investment Strategy investing £15.2bn over the next five years and having already rolled out a further £5bn of contracts to date. The percentage of savings might be higher than 1% in the future as Tier 2 & 3 suppliers start to reflect accelerated payment as part of their price structure.

One of the key advantages of PBAs is the protection afforded in the event of contractor insolvency. To date Highways England has not had to test the effectiveness of this, although it provides confidence to the supply chain that they will be paid for work performed. When associated with the advantage of speed of payment the supply chain have indicated that they are likely to prefer contracts that have a PBA clause. This will become a more important issue as the industry continues its recovery from the recession.

In 2012 the government announced an aspiration that 25% of central government procurement spend to be awarded to small and medium enterprises (SMEs) (Cabinet Office, 2012c). Due to the size of the contracts Highways England award (often running into 10's or 100's of millions) relatively few contracts are awarded directly to SMEs. Following the introduction of Project Bank Accounts, Highways England have been able to understand the nature of the supply chain in detail and found that on average 30% of spend across all tiers are SMEs. This figure is conservative as any suppliers who have not signed up to the PBA are treated as Non SMEs for reporting purposes when in practice it is likely to be a mix. As a result the real figure is likely to be in the region of 35 - 40% which is far higher than anticipated.

Whilst there are relatively few material disadvantages to PBAs there has been a long standing criticism about the amount of extra administration required. Highways England has found the additional time required by both client and lead contractor to be relatively modest with the exception of the initial creation of the PBA with the bank. For each contract a new PBA is established, requiring the supply chain to supply a one page Joining Deed which affords them protection in the event of insolvency. As there are 20-40 Tier 2 suppliers on a typical contract with many more at Tier 3 level this inevitably leads to some additional administration. However, once the Joining Deeds are supplied at the outset of the contract, the amount of ongoing administration is similar to any other non PBA contract.

One of the ongoing issues surrounds the issue of a Tier 1 contractor making payment directly to the Tier 3 when there is no direct contractual relationship between the two. Whilst it is straight forward to make the physical payment out of the bank account to the Tier 3, it is recognised that accounting systems are not always set in a way that recognises the split between Tier 2 & 3. This was initially an important issue on the earlier PBAs where payments were only being made to Tier 2, but as PBAs gain wider recognition it is becoming far more common to see payments being made down to Tier 3 level.

The Cabinet Office (Cabinet Office, 2012b) has set a target of 80% of Tier 2 & 3 by value to be paid from the PBA. This can encourage the Tier 1 contractor to focus on getting the larger value sub-contracts signed up the PBA who are less likely to be SMEs. As a result there is a danger of smaller enterprises which require the protection that PBAs afford are denied the opportunity by the Tier 1 to join. Such issues can be overcome through careful review of management information provided by the contractor and the incentivisation through performance metrics that rewards a higher percentage of sub contracted value to be signed up to the PBA. There is also the option for the Tier 2 & 3 sub-contractors to apply to Highways England directly as client.

4. Implementation Strategy

When Highways England announced its intention to introduce PBAs there was initially significant resistance amongst Tier 1 contractors, although it was an initiative welcomed by suppliers further down the supply chain. A workshop was held with the Tier 1 contractors to explain the concept in further detail and to dispel many of the myths. The key concerns together with the response are shown in Figure 2.

Figure 2. – Tier 1 concerns.

	Perception	Reality
1	Complicated and time consuming to set up	No different to a conventional account
2	Expensive and only viable on large schemes	Costs are modest (<£1000)
3	Impacts tier 1 turnover and shareholder value	UK GAAP PS application note G para G60-72 confirms no change
4	Cuts across contractual provisions re valuation and certification of assessments	PBA s do not impact contractual provisions
5	Undermines lead contractors responsibility for managing the supply chain so that work is performed in accordance with the contract	No change to tier 1-3 contractual and statutory responsibilities
6	Difficult for tiers 2/3 to implement	Welcomed by SEC and NSCC
7	Creates CIS and VAT problems	HMRC confirms no impact
8	Complications with 'pay less' notices	No impact
9	Difficult to demonstrate financial benefits	Agreed but see CO impact assessment
10	Impacts factored debts	PBAs should reduce need
11	PBA costs will increase as banks become involved with contractual issues	Banks not involved-PBA is purely a payment conduit
12	Client has to physically authorise each payment on the banking system	Under NEC contractor instructs bank after agreeing detail with client
13	Client has to be a trustee to ensure protection/continuity in the event of liquidation	Under NEC lead contractor is sole trustee

The implementation strategy was to focus on schemes that were nearing construction to allow sufficient time for the bank accounts to be created and provided an opportunity for suppliers to join the PBA at the outset. It was felt that to retrospectively introduce PBAs on schemes already in construction would dilute the benefits and would be too administratively burdensome. The focus was to roll out PBAs on Major Project schemes first as up to 80% of work is carried out by Tier 2 & 3 sub-contractors and subsequently roll out to maintenance providers at a later date.

One of the main issues at the outset was an underestimation of the amount of time required by the banks to set up the PBA. The rollout strategy had allowed for an average of four weeks from point of application to opening of the account. In reality it was initially taking anything up to 3 months in part due to the governance checks that the banks needed to undertake and also relatively poor knowledge of what is a relatively specialist product. As of 2015, now that PBAs are more embedded the end to end process takes circa. 4 weeks to complete.

The initial intention was that Highways England would have direct access to the portal of each bank to view the transactions. In the earlier stages of the rollout when only a handful of PBAs were in operation this worked well, but as further PBAs were introduced it became easier to receive a monthly pdf file directly from the Tier 1 contractor. This saved time when initially creating the PBA and negated the need for individual logons and adaption of technology to meet the requirements of each bank.

When new suppliers wanted to join the Project Bank Account a simple Joining Deed is required using the template provided by NEC. These require signature by both the Tier 1 contractor and the client and is then sealed on behalf of the Secretary of State. Once sealed, the supplier can then be paid from the PBA and is protected in the event of insolvency. On average the process takes 1-2 weeks although as the Tier 2 & 3 sub-contractors are often known months before the works taking place, the Joining Deed could be completed at the outset of the contract, even if in practice the supplier is not on site until many months later.

The original intention was for the information provided in the pdf bank statement be sufficient to provide assurance that the PBA was operating as intended. However, it provided little visibility as to which suppliers were being paid from the PBA, the nature of the supply chain (e.g. proportion of SMEs) and speed of payment could only be calculated manually. As a result Highways England developed a one page Excel spreadsheet (Figure 3.) that each Tier 1 contractor was expected to complete on a monthly basis that detailed the outgoing payments. The information was then used to automatically measure performance, speed of payment and proportion of SME spend.

Figure 3. – Spreadsheet used to monitor PBA performance (anonymised).

Application No:	6
Assessment Date	25-Dec-11
Amount Certified (inc VAT)	3,889,017.34
Payment received from HA:	30-Dec-11

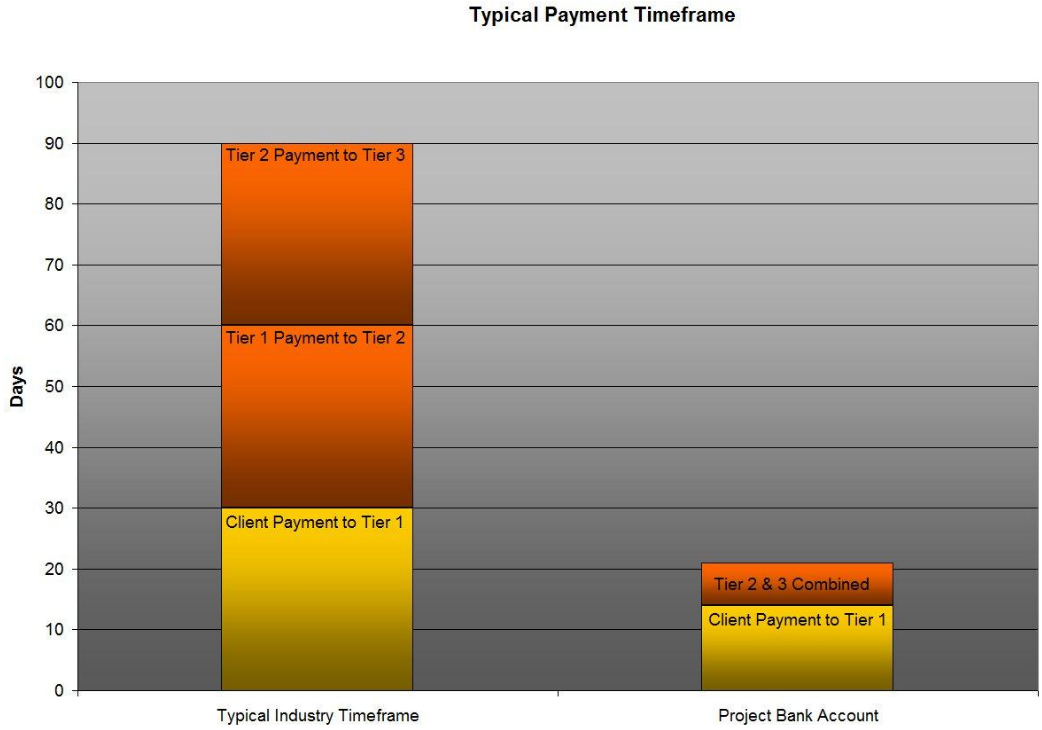
Project Bank Account Details				**PBA**	**Actual Payment Details**		**Actual Payment Date**
Period Certifeid Amounts	Net	VAT	Gross	Carried Forward	Gross	Balance in PBA	
Tier 1							
Supplier A	£ 346,708.28	£ 69,341.66	£ **416,049.93**		£ 416,049.93		
Tier 2							
Supplier B	£ 30,000.05	£ 6,000.01	£ **36,000.06**	£ 27,362.46	£ 29,946.00	£ 33,416.52	12-Jan-2012
Supplier C	£ 70,000.17	£ 14,000.03	£ **84,000.20**	-£ 57,004.39	£ 76,407.46	-£ 49,411.64	13-Jan-2012
Supplier D	£ 75,293.82	£ 15,058.76	£ **90,352.58**	£ 85,090.58	£ 77,563.27	£ 97,879.90	12-Jan-2012
Supplier E	£ 50,999.92	£ 10,199.98	£ **61,199.90**	-£ 25,022.50	£ 54,769.39	-£ 18,591.98	12-Jan-2012
Supplier F	£ 4,966.98	£ 993.40	£ **5,960.38**	-£ 3,639.65	£ 19,631.39	-£ 17,310.66	12-Jan-2012
Supplier G	£ 430,650.92	£ 86,130.18	£ **516,781.10**	-£ 3,622.90	£ 504,932.47	£ 8,225.74	13-Jan-2012
Supplier H	£ 118,269.06	£ 23,653.81	£ **141,922.87**		£ 112,684.87	£ 29,238.00	12-Jan-2012
Supplier I	£ 598,383.72	£ 119,676.74	£ **718,060.46**		£ 705,830.54	£ 12,229.92	13-Jan-2012
Supplier J	£ 137,013.63	£ 27,402.73	£ **164,416.36**		£ 160,629.11	£ 3,787.25	13-Jan-2012
Supplier K							
Supplier L							
Supplier M							
Supplier N							
Supplier O							
Supplier P							
Supplier Q							
Supplier R							
Supplier S							
		Total	£ 3,889,017.33	£ 23,163.61	£ 3,812,717.91	£ 99,463.03	
		Reconciliation	*0.00*	*0.00*	**Adjustments b/f**		
					Adjustments		
					Adjustments c/f		
					Bank Balance	£ 99,463.03	

5. Results

Highways England was set a target to deliver £3.7bn of contract value against a wider government target of £4.0bn that contained a PBA. Over the first three years ending 2013/14 it was conservatively estimated that Highways England delivered £4.5bn of contracts and it is estimated that by 2020 this figure will rise to £20bn.

As of April 2015 there are some 35+ Project Bank Accounts in operation across a suite of Highways England major schemes and maintenance contracts. Following review of these PBAs the average time Highways England took to fund the accounts was 12 days on average and a further 7 days on average for payments to be made to the supply chain. As a result the payment cycle down to Tier 3 level on average is completed 19 days after the assessment date. This compares favourably to the Cabinet Office study (Cabinet Office, 2012a) that stated lower levels of the supply chain are waiting up to 100 days to be paid (Figure 4.).

Figure 4. – Comparison of typical payment timescale with and without PBA.



As a case study the M4 J19-20 & M5 J15-17 Smart Motorway Scheme which was opened in January 2014 was amongst the first to introduce a PBA. The Tier 1, Balfour Beatty signed up 86% of its supply chain by value which included 25 SMEs. Balfour Beatty made payment to its supply chain within 7 days of receiving funds and the payment cycle was on average completed within 20 calendar days of the assessment. Following completion of the scheme, feedback was sought from the supply chain and comments such as below were typical:

Supplier A

"We have been very impressed with the seamless and timely payments. We receive clear notification of money due on a monthly basis and this assists us greatly with cash flow forecasting. We believe that Project Bank Accounts have worked well for the supply chain."

Supplier B

"The PBA enables us to manage our business more effectively from a cash flow perspective and enables us to pay our suppliers on a similar basis reducing their cash flow borrowing and associated costs."

Supplier C

"The Project Bank Account worked very well and we were very pleased with the way it was administered. Once an application had been certified payments were always made in line with the agreed schedule. We were also able to pass on these positive aspects of the Project Bank Account to our supply chain who also benefited from it."

On the earlier contracts most of the success was achieved in signing up the Tier 2 sub-contractors and only modest progress was made paying Tier 3. This was in part caused by the newness and unfamiliarity of Project Back Accounts and it was imperative that the rollout succeeded and lessons learnt could then be used to inform future rollouts that included Tier 3. There still remains a degree of reluctance amongst Tier 1 contractors to sign up Tier 3 sub-contractors, mostly due to the lack of a direct contractual relationship between the two parties. This is being slowly overcome and payments are being made down to Tier 3 level on a regular basis, although further work is required to ensure such payments become the norm and not the exception.

There remains criticism that PBAs are disproportionately administratively burdensome. Whilst there is limited evidence to support this assertion, Highways England are exploring ways to further reduce the amount of administration such as using Project Bank Accounts on framework contracts that will only require a single PBA for each framework, rather than requiring a new PBA for each award. This will also save time when signing up Tier 2 and 3 sub-contractors as only a single Joining Deed would be required. Another approach being investigated is the re-cycling of a bank account when a scheme has finished which can be used on a new scheme in the future. This would only require the existing bank account to be renamed although would still require a fresh Trust Deed and Joining Deeds. It may also be possible in the future for sub-contractors to supply a Joining Deed once that would be sufficient for a suite of schemes.

6. Conclusions

It has been a long standing issue within the construction industry for suppliers to wait up to 120 days to be paid. Whilst various initiatives have been introduced since Michael Latham's 1994 'Constructing the Team', none of them have made a break through impact across the industry. In 2007 the introduction of the Fair Payment Charter had a limited positive impact but Highways England own evidence has shown that it is not always adhered to and is therefore not the long term answer to address continued poor payment practices that are prevalent.

The introduction of Project Bank Accounts across Highways England schemes have shown that the payment cycle down to Tier 3 level can be achieved within 21 days of the assessment whilst also protecting the funds in the event of insolvency. Whilst it is typical for 80%+ of the supply chain by value to be signed up to a PBA, further work is required to improve this figure to ensure all of the supply chain can benefit.

No other initiative has been able to comprehensively reduce the payment cycle as much as a Project Bank Account, although take up within publically funded projects outside of Highways England have to date been modest. However, there is growing awareness of the benefits that Project Bank Accounts can bring amongst both central and local government and from further afield such as the Western Australian State who have decided to implement a trial.

Overall, it is clear that Project Bank Accounts are having a positive impact upon the industry and go some way to address the perceived view of poor payment practices being prevalent. As has been demonstrated, Project Bank Accounts should be considered both within the public and private sectors as a tool to drive further efficiencies, protect both the client and supply chain from insolvency and to encourage collaborative and innovative behaviour between all parties.

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