Department of Legislative Services

Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1154 (Delegate D. Barnes)
Health and Government Operations

State Procurement - Payment Practices

This bill establishes that it is the policy of the State to make payments under procurement contracts within 15 days (instead of 30 days) after (1) a payment becomes due or (2) if later, when an agency receives an invoice. It further requires that interest on any unpaid amount begins accruing and is payable on the sixteenth day after (1) a payment comes due or (2) if later, when an agency receives an invoice. **The bill takes effect June 1, 2023.**

Fiscal Summary

State Effect: General and special fund expenditures increase significantly, likely by at least $1.0 million, to pay interest penalties on unpaid invoices. Alternatively, general and special fund expenditures increase significantly more if the State expands staff to meet the bill's new, tighter deadline for paying contract invoices, as discussed below. No effect on revenues.

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Current Law: It is the policy of the State to make a payment under a procurement contract within 30 days after (1) the day on which a payment becomes due under a contract or (2) if later, the day on which the agency receives an invoice. For payments that are payable under the terms of a written contract, interest on unpaid balances accrues at the annual rate of 9% beginning after 45 days. For payments that are due for an invoice, interest accrues at the same rate beginning after 30 days but is not payable until after 45 days, giving agencies a "grace period" of two weeks to make the payment until interest is payable. Beginning June 1, 2023, interest on unpaid balances is payable after 37 days, shortening the grace period to one week. An agency is not liable for interest on unpaid invoices:

- unless the contractor submits an invoice for the interest within 30 days of the date on the State's check;
- if the contractor files a contract claim;
- for interest that accrues for more than one year; or
- on an amount that represents unpaid interest.

Chapters 157 and 158 of 2022 required the Department of Legislative Services (DLS) to report to the General Assembly by December 1, 2022, the following information for each unit of State government:

- the number of staff whose work responsibilities involve processing procurement contract payments and the number of vacancies in those positions; and
- for the prior three fiscal years (1) the average time for a unit to process procurement contract payments and (2) the percentage of contract payments paid within 30 days, between 30 and 37 days, between 37 and 45 days, and more than 45 days after the payments are due.

Based on this information, DLS had to assess the fiscal impact to the State of reducing the number of days following receipt of an invoice (1) after which the State owes interest on unpaid amounts and (2) after which interest begins to accrue on unpaid interest. The DLS report is available on its website.

State Expenditures: Data available from the Comptroller's Office for the required study allowed DLS to determine the percentage of payments delivered by agencies to the Comptroller's Office for processing within 25 days (giving the Comptroller five days to make the payment within the 30-day window). The data do not allow for an analysis of the number of payments made within 15 days. Moreover, any such analysis would not be appropriate or valid because faster payments are not required by law.

Overall, the DLS study found that State agencies paid at least 91% of payments on time from fiscal 2019 through 2022; on-time performance was higher prior to the COVID-19 pandemic but declined during the pandemic due to the sheer volume of payments and staff shortages. The analysis found that requiring interest to be payable after 30 days instead of 45 days would increase State interest liability by between $400,000 and $1.0 million annually.

As noted, data from the Comptroller's Office does not allow for a similar analysis based on interest accruing and being payable after 15 days, but undoubtedly the increase in State liability will be substantially greater. For the DLS study, many agencies pointed to the complexity of invoices, staff shortages (which averaged 13%), and the State's outdated Financial Management Information System as barriers to substantially improving on-time payment performance. Each invoice received by an agency must be reviewed for accuracy and compliance, and that process takes time, especially for large and complex projects. Therefore, it is likely that many payments would not or could not be made within the 15-day period established by the bill, and State liability for penalty interest would increase significantly.

Although a reliable estimate of the increase in liabilities is not feasible in the absence of experience, the increase likely exceeds $1.0 million. The DLS study found that a reduction from 45 days to 30 days would increase interest liability by up to $1.0 million, and a further reduction to 15 days is anticipated to increase payable interest by at least that much. DLS notes that the amount of interest actually paid by State agencies may be less because, under current law, interest is not payable unless invoiced by the contractor. The Comptroller's Office has advised that very few contractors submit invoices for penalty interest, even when they are owed (the University System of Maryland advises that it has not received an invoice for interest in more than one year).

Many State construction contracts, particularly for transportation projects, use federal funds. However, federal funds cannot be used to pay contract penalties. Therefore, general and special funds are needed to pay interest penalties on all projects, including those paid in whole or in part with federal funds.

An alternative response to the bill's provisions involves expanding Executive Branch staffing to process more invoices within the bill's 15-day deadline – in an attempt to both honor that deadline being the policy of the State and avoid or mitigate the accrual of interest penalties. DLS notes that any such expansion would affect contract management staff as well as finance staff, as both groups are involved in the review and processing of contract payments. A conservative estimate is that agencies, particularly those with a large volume of contracts and many complicated projects, would have to double the size of their contract management and finance staffs to achieve a meaningful reduction in the number of days necessary to process contract payments. Given current vacancy rates in many agencies, it is unlikely that they could achieve an expansion of staff of that magnitude. Moreover, the cost of doing so across the Executive Branch would far exceed the cost of paying increased interest penalties with existing staff, likely by millions of dollars. Even with a staffing expansion, some contracts would likely continue to be paid late under the tighter deadline, still resulting in some interest penalties being due.

Small Business Effect: To the extent that the bill creates an incentive for State agencies to pay invoices faster, small contractors receive payments from the State in a more timely fashion. To the extent that agencies are not able to meet the shorter deadline, interest payments to small businesses may increase.

Additional Information

Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: None.

Information Source(s): Comptroller's Office; Department of Information Technology; State Board of Contract Appeals; Department of Commerce; Maryland Commission on Civil Rights; Maryland Department of Emergency Management; Alcohol and Tobacco Commission; Maryland School for the Deaf; Maryland Higher Education Commission; Maryland State Library Agency; Baltimore City Community College; University System of Maryland; Maryland Center for School Safety; Maryland Department of Agriculture; Maryland Department of the Environment; Department of General Services; Maryland Department of Health; Department of Housing and Community Development; Department of Human Services; Department of Juvenile Services; Maryland Department of Planning; Department of Public Safety and Correctional Services; Board of Public Works; Department of State Police; Maryland Department of Transportation; Department of Veterans Affairs; Office of Administrative Hearings; State Department of Assessments and Taxation; State Ethics Commission; Maryland Health Benefit Exchange; Maryland Insurance Administration; Maryland State Lottery and Gaming Control Agency; Public Service Commission; Department of Legislative Services

Fiscal Note History: First Reader - March 3, 2023
km/ljm

Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510