



# **KZN Housing**

**uMnyango:  
wezeZindlu  
ISIFUNDAZWE SAKWAZULU-NATAL**

## **SUBMISSION**

<b>TO</b>	<b>ACTING CHIEF OPERATIONS OFFICER</b>	
<b>ATTENTION</b>	<b>MR JSN NXUMALO</b>	
<b>DATE</b>	<b>9 JUNE 2009</b>	
<b>ENQUIRIES</b>	<b>PRODUCT DEVELOPMENT : M Milne</b>	<b>REF: 1/P</b>
<b>SUBJECT</b>	<b>GUIDELINES FOR THE TRANCHE PAYMENT SYSTEM FOR ADVANCE PAYMENTS</b>	

### **1 PROBLEM STATEMENT**

In terms of Section 17(4) of the division of Revenue Act 2008 (DORA), advance payments may not be made in respect of implementation activities to be undertaken in the next financial year.

The department is currently experiencing problems with the manner in which tranche payments which are paid in advance to municipalities/ developers and section 21 companies and/or accounts administrators are expended. There are no monitoring systems in place and as a result large sums of funds transferred stay unutilised for a period more than a year in accounts of municipalities and such funds end up not being used for their intended purpose.

### **2 PURPOSE OF GUIDELINE**

The purpose of the policy guideline is to revise the tranche payment system in the Province in order to improve control. Payments will be linked to deliverables relating to a particular financial year to be achieved. In instances where upfront tranche payments are made such payments will be linked to the development programme of the project.

### **3 BACKGROUND**

- 3.1** In April 2003 the National Department of Housing (NDoH) approved the Tranche Payment System. This system was incorporated to the so-called "Revised Chapter 3 : Policy for Greenfields Project Linked Subsidies". This system replaced the previous progress draw system (so-called P1-P5 Progress Draw System").

- 3.2** The purpose of the tranche system and in particular that of advanced payments is to prevent adverse cash flow implications for contractors and to ensure that all payments are based on deliverables and value for money is achieved. The tranche system provides for a range of sub-milestones for specific activities, for service providers to be paid for work done, provided the necessary completion certificates/proof of work has been submitted.

Where advance payments have been made to the municipality, payment for sub-milestone completion would be made by the municipality. It should be noted, however, that the advance payment to municipalities is not compulsory. In such cases, payment on the completion of such sub-milestones will be effected by the Department, either via the municipality or directly to the service provider, depending on the contractual arrangement

- 3.3** In terms of the **national** housing policy:

- (a) The Provincial Housing Department is to allocate funds in three tranches for each a project (Project Linked Subsidies) for control purposes.
- (b) Funds may be released in advance to the maximum of each tranche amount. The Division of Revenue Act further requires that such funding must be utilised within the financial year in which it is advanced to the municipality/accounts administrator.
- (c) Developers may claim interim payments for the achievement of sub-milestones in each tranche to the maximum value allocated in the respective tranche.

- 3.4** The following concerns have been raised in KZN regarding the tranche payment system:

- (a) Large sums of money are in municipal/section 21 companies' accounts.
- (b) Funds may not be used for their intended purpose.
- (c) There is an unclear monitoring and evaluation system.
- (d) Roles and responsibilities are not clearly defined.
- (e) Delay in the payment of service providers.

- 3.5** On 6 February 2008 the department held a policy debate workshop to determine whether the practice of advance tranche payment system should be used within the Province. It was agreed that a provincial guideline should be developed to guide circumstances and requirements for such payments and implement control measures to ensure that funds are used for their intended purpose. This would include identifying the roles and responsibilities of respective components in the process. These are outlined in section 4, below:

## **4 GUIDELINES FOR THE TRANCHE PAYMENT SYSTEM**

These guidelines are applicable to all instances where funding is advanced for works still to be done, irrespective of the subsidy instrument (People's Housing Process, Project Linked varieties, Rural, Institutional, etc). Advance payments can only be done to organs of state and in terms of the relevant financial laws, prescripts and regulations. The following provincial requirements, in addition to those defined in terms of National Housing policy are to be considered in ensuring the efficient implementation of the tranche system and advance payments to municipalities:

### **4.1 GENERAL REQUIREMENTS**

- 4.1.1 The municipality/section 21 company must open a separate account for each project.
- 4.1.2 Advance payments and sub-milestone payments will be paid into the primary bank account and must be immediately transferred to the separate project account.
- 4.1.3 Interest less bank charges must be transferred to the Municipal Housing Operating Account.

### **4.2 REQUIREMENTS FOR SUB-MILESTONE PAYMENTS**

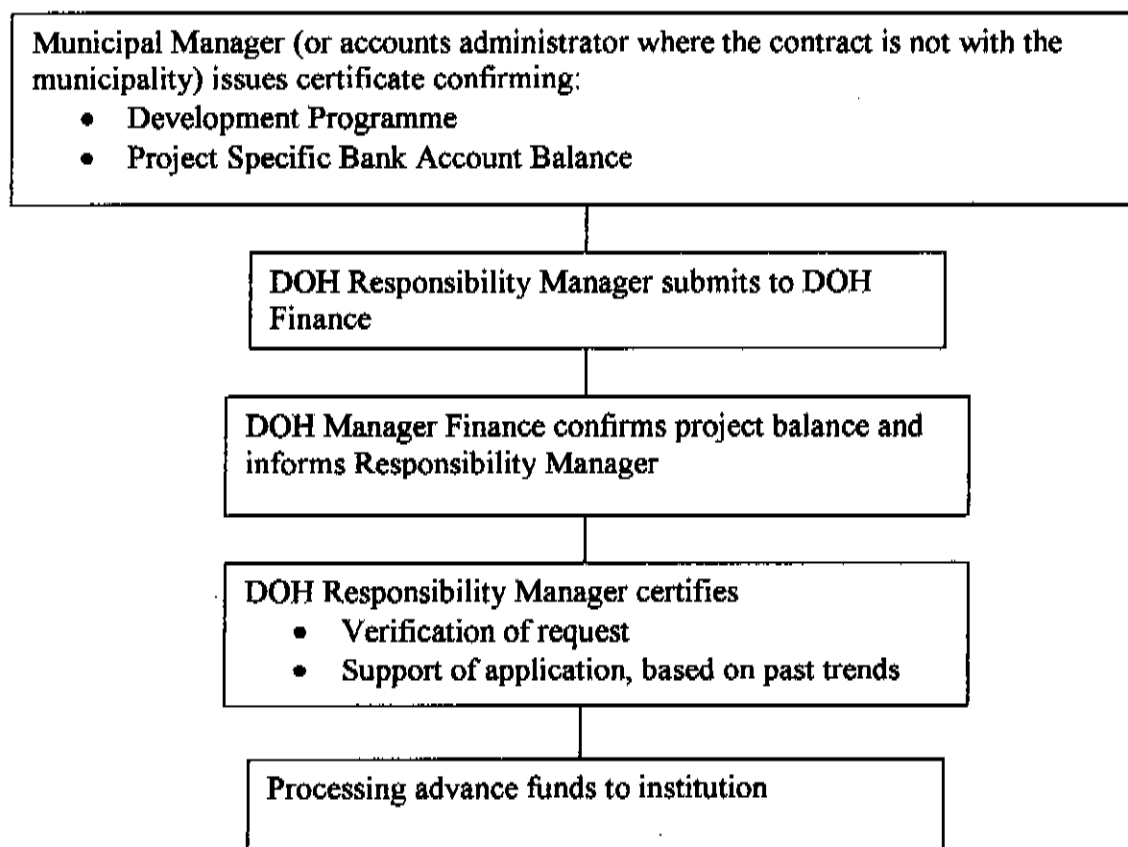
- 4.2.1 All payments to service providers, including contractors will be from the funds advanced and only in respect of the value of work done to ensure that value for money is achieved.
- 4.2.2 An implementing agent may claim for interim payments for achievement of sub-milestones within a tranche up to the maximum amount allocated in the respective tranche.

### **4.3 REQUIREMENTS FOR ADVANCE TRANCHE PAYMENTS**

- 4.3.1 In instances where advance payments are paid the project management component (or component responsible for managing the implementation of the contract) must submit a motivation based on the criteria that was assessed and must include a realistic development programme and cash flow on a phased approach.
- 4.3.2 Funds advanced to municipalities must be spent in the financial year (1 April to 31 March), as required in terms of the Division of Revenue Act (DORA). Any funds not spent will have to be recovered as required in terms of the said Act. Care must thus be taken to ensure realistic development programmes and project budgets are in place, and this should be properly certified (see paragraph 4.3.3 below).

- 4.3.2 The project Memorandum of Agreement must specify the terms of the advance payments and the unit responsible for monitoring the Municipal Housing Operating Account must be informed of such terms.
- 4.3.3 Prior to the release of advance funds, a certificate will be submitted to by the municipality, signed by the Municipal Manager, confirming the balance of funds in the particular project account, its development programme and its projected monthly expenditure for the financial year (1 April to 31 March). These documents should be sent to the Regional Manager or Responsibility Manager responsible for overseeing the project on behalf of the Department, who will forward the document to the Finance Component for endorsement.
- 4.3.4 The Manager responsible for Finance or his/her delegate, will confirm in writing the balance of funds in the project specific account.
- 4.3.5 The Responsibility Manager for the component implementing and/or overseeing the project), will confirm in writing that his/her component has assessed the application, and based on performance trends that the release of advance funds is supported. This process is summarised as follows:

Figure 1 : Release of advance funds



- 4.3.6 Further tranche payments will be released only on proof that at least 80% of the work to be done in terms of the programme for the previous advance, and relevant obligations in terms of the Memorandum of Agreement in respect of the said milestones has been completed. This provision applies to the completion of milestones within a tranche, only. Advance funds for further tranches can only be released once all milestones have been completed, as stipulated in terms of the agreement and in terms of policy, and provided all the required certificates for proof of completion are attached and complies with the provisions of policy.

#### **4.4 ASSESSMENT CRITERIA FOR ADVANCE PAYMENTS**

The municipality's capacity must be formally assessed and signed off by the Chief Operating Officer and the Chief Financial Officer, in terms of the criteria listed below, before being approved to receive Tranche Payments on a project. This assessment must be conducted at the inception of each project and be updated on an annual basis within 3 months of receiving the audit report for the preceding financial year. In the case of existing projects, this report will be required before any further tranche payments are made (after the approval date of this guideline).

Should the municipality or organ of state not be able to satisfy the criteria listed below, the normal progress draw system for payment of completed work would apply (subject to the approval of the project)

- (a) The performance trend over a three year cycle in terms of previous housing project development programmes, correct reconciliations and a dedicated and functioning housing unit.
- (b) If there was any non-performance by the municipality over the three year cycle and this was due to circumstances beyond their control then reasons for such non-performance must be taken into consideration.
- (c) In instances where it is not possible to obtain records over a three year cycle, financial records gathered from the municipality, institutions or from Department of Local Government and Traditional Affairs and/or Office of the Auditor-General should be considered.
- (d) The component responsible for monitoring the Municipal Housing Operating Account (MHOA sub-directorate) must provide comment on the manner in which the municipality manages its financial records. The municipality must have proper accounting systems and procedures in place to manage advance and sub-milestone payments.

- (e) In instances where a municipality has not undertaken a housing project, Department of Water Affairs and /Forestry or the Department of Local Government and Traditional Affairs in respect of MIG funding must be consulted to determine the performance of the municipality in their projects.
- (f) The audit report from the Auditor-General for the 3 preceding financial years must be unqualified specifically with regard to financial issues. A "Going Concern" qualification paragraph in the audit report will automatically result in the disqualification from receiving Tranche payments.

#### **4.5 REQUIREMENTS FOR RELEASE OF PAYMENTS**

Once the project agreement has been signed, the following will apply:

- 4.5.1 Payments will be released according to the current policy i.e. advance and milestone payments will be paid by the municipality to the service provider only upon authority from the department.
- 4.5.2 The Project Management Regional Office (or office responsible for monitoring the implementation of the contract) will notify the Subsidy Administration Directorate. The Subsidy administration Component will capture the relevant information and submit the request for payment to the Finance Directorate in order for the required funds to be released to the municipality.
- 4.5.3 The release of payments for milestones will be based on an invoice submitted to the Regional Office which will determine compliance with the project agreement and confirm that the work has been completed. Thereafter, the claim must be submitted to the Subsidy Administration Directorate that will capture the relevant information and issue a letter of release to the Regional Office which will then forward the letter to the municipality to authorize payment.
- 4.5.4 In instances where advance payments have been released in terms of the development programme proof of completion of the milestones linked to the particular tranche payment must be submitted prior to the release of the next tranche payment.

**4.6 CONTROL OF TRANCHE PAYMENTS**

- 4.6.1 The project monitor, or official responsible for monitoring the project, will be responsible for ensuring that all supporting documents for the release of sub-milestones are submitted by the developer.
- 4.6.2 Prior to certifying the documentation for payment the project monitor must conduct a site inspection to confirm that the respective sub-milestone(s) have been achieved.
- 4.6.3 In instances where advance payments have been released, the project monitor must ensure that the development programme milestones linked to the respective tranche payment is complete prior to approving the release of the next tranche payment.
- 4.6.4 Non-compliance must be assessed against the agreed development programme. Reasons for deviation must be clearly stated, and a programme of corrective action must be formally recorded.
- 4.6.5 If the project becomes blocked no further tranche payments will be released until the project is unblocked. If the blocking of the project is the fault of the developer, the developer will bear all escalations linked to the particular tranche payment.

**4.7 MONITORING OF TRANCHE PAYMENTS**

- 4.7.1 The MHOA sub-directorate will be responsible for monitoring advance payments by ensuring that:
- Funds advanced are kept in a separate account,
  - Proper reconciliation of such funds is done on a monthly basis.
  - Interest accumulated on the funds less bank charges are transferred to the MHOA.
  - Ensure that funds are paid out for activities authorised by the Department.
  - Report any irregularities relating to the finances to the Manager responsible for overseeing the implementation of the contract for necessary action to be undertaken against the municipality/section 21 company.
  - Such Manager must within 30 days notify the municipality of the irregularity and the consequences should this not be corrected.
  - Any irregularities not corrected within 3 months of being reported, will result in any advance funds held by the municipality being recalled by the Department.

- 4.7.2 Project management, or the component responsible for managing and/or overseeing the implementation of the contract, must ensure that advance payments are used for the purpose as indicated in the development programme.

#### **4.8 REPORTING FOR ADVANCE PAYMENTS**

- 4.8.1 The municipality must maintain proper financial records of the separate project account. The supporting documents must be maintained in an orderly manner and must be readily available for audit by the MHOA sub-directorate.
- 4.8.2 The municipality must submit financial reconciliation reports by the 7<sup>th</sup> working day of the next month to the MHOA sub-directorate.
- 4.8.3 When the project is completed the municipality must submit a close out report by the 7<sup>th</sup> working day of the next quarter to Project Management and the MHOA sub- directorate.

#### **4.9 CONTRACTUAL ARRANGEMENTS**

- 4.9.1 The agreement between the Department of Housing and the developer must be project specific.
- 4.9.2 Contracts must be managed and penalty clauses must be implemented where monies are not used for their intended purpose as stated in the development programme

### **5. FINANCIAL IMPLICATIONS**

The project budget will compute to the value of the applicable subsidy amounts of the approved beneficiaries plus the variation calculation(s) as per the variation manual calculator, and annual adjustments relating to escalation.

### **6. MOTIVATION**

- 6.1 In instances where sub-milestone payments are released the monitoring and control systems as per the guideline will ensure that value for money is achieved as payments will be based on deliverables.
- 6.2 In instances where advance payments are made the monitoring systems that are put in place must ensure that all payments are linked to the development programme of the project.
- 6.3 The guideline for the tranche payment system will ensure that sub-




milestones and advance tranche payments that are released will be paid to the - maximum allowable amount and such releases will be as per the development programme of the project.

## 7 RECOMMENDATION

It is recommended that the guideline for the Tranche Payment System outlined in paragraph 4 be approved.

### SUBMITTED



**MRS M. MILNE**  
**MANAGER: PRODUCT DEVELOPMENT**

11/6/2009  
**DATE**

### SUPPORTED/ NOT SUPPORTED/ SUPPORTED AS AMENDED



**MS Z MYENI**  
**ACTING CHIEF FINANCIAL OFFICER**

24/6/09  
**DATE**


**COMMENTS** ① Task team to include subsidy administration and property management component.

② Managers from the various components identified will be members of the task team as resolved in the RAC meeting.

**7 RECOMMENDATION**

It is recommended that the guideline for the Tranche Payment system outlined in paragraph 4 be approved.

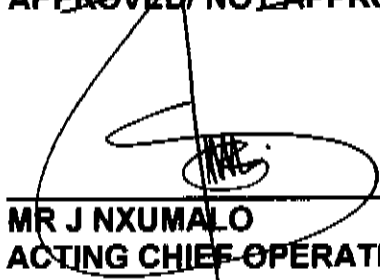
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**MS T. NTIKINCA**  
**GENERAL MANAGER :**  
**PLANNING AND DEVELOPMENT**

17.06.09  
**DATE**

**COMMENTS** *I* .....  
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~~APPROVED/ NOT APPROVED/ APPROVED AS AMENDED~~

  
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**MR J NXUMALO**  
**ACTING CHIEF OPERATIONS OFFICER**

13/07/2009  
**DATE**

**COMMENTS** *Refer ACT. CFO Comments* .....  
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