

STREAMLINING PAYMENT PROCESSES

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Synopsis:

The legislative framework for public administration requires that organs of state pay their contractors promptly and certainly within the period agreed to in contracts. Many organs of state are failing to do so.

This practice note reviews the three phases of the payment cycle, namely certification, authorisation and processing, and examines the flow of funds between the client departments and the implementing agents. It suggests how organs of state can streamline their certification, authorisation and payment processes to effect payment to contractors within the stipulated time as per the contract.

cidb's inform practice notes provide guidance and clarity in achieving client objectives in construction procurement and delivery. Practice notes inform clients and practitioners on how to embrace best practice and to deal with issues that may arise. They are aligned with, but do not replace regulation.

Fair payment

Payment is remuneration for work or services properly carried out. 'Fair Payment' is concerned with whether the contractual terms relating to the discharge of the payment obligation and the payment process are fair and adhered to. (Office of Government Commence (UK))

The guiding principles for fair payment include:

- *Payment process should be transparent.*
- *Contractors should have access to procedures for certification and payment as well as the duration of the procedures.*
- *Contractors have a right to receive full payment as and when due and deliberate late payment is unethical.*
- *Fair payment should apply equally between the client and main contractor throughout the supply chain.*
- *Contractors should be able to claim interest on late payment in terms of the contract whenever payment is late.*

Current infrastructure payment challenges

- long periods for the completion of payment cycle;
- double-handling of certain authorisation actions;
- limited delegations to authorise payments;
- financial systems are often off-line;
- lack of systems integration resulting in double capturing of the same information during different stages of payment or contract management; and
- lack of capacity within the delivery chain including the payment cycle.

The two parties to a **contract** are the **employer** and the **contractor** i.e. the signatories to the contract.

1. Introduction

The **cidb** through its partnership programme with the National Treasury, Development Bank of Southern Africa (DBSA), and National Department of Public Works (NDPW) named the Infrastructure Delivery Improvement Programme (IDIP) has identified that delayed payment to contractors is one of the main blockages to infrastructure delivery in the public sector.

Failure by the employer to pay contractors within the period stipulated in their contracts potentially results in:

- the slowing of service delivery
- poor quality of infrastructure built
- poor performance of contractors
- the potential demise of contractors due to severe negative cash flow, particularly emerging contractors who are the most vulnerable
- clients being exposed to the risk of unfinished or poorly finished projects
- interest charges being incurred, i.e. fruitless and wasteful expenditure

Public Finance Management Act, 1999 (Act 1 of 1999)

38(1) The accounting officer for a department ...

(a)(i) must ensure that department ... has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

(f) must settle all contractual obligations and pay all money owing ... within the prescribed or agreed period.

Treasury Regulations for departments, trading entities,

constitutional institutions and public entities, issued in terms of the Public Finance Management Act, 1999

8.1.1 The accounting officer of an institution must ensure that internal procedures and internal control measures are in place for payment approval and processing. These internal controls should provide reasonable assurance that all expenditure is necessary, appropriate, paid promptly and is adequately recorded and reported.

Local Government Municipal Finance Management Act 56 of 2003

65(2) The accounting officer musttake all reasonable steps to ensure-

(a) that the municipality has and maintains an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds;

(d) that payments by the municipality are made-

(i) directly to the person to whom it is due unless agreed otherwise for reasons as may be prescribed; and

(ii) either electronically or by way of non-transferable cheques, provided that cash payments and payments by way of cash cheques may be made for exceptional reasons only, and only up to a prescribed limit;

(e) that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement, unless prescribed otherwise for certain categories of expenditure

The payment cycle can be grouped into three broad phases namely:

- **Payment certification** (evaluation of works and preparation of certificate) normally undertaken by the employer's agent (e.g. Services Manager, Engineer, Principal Agent, Project Manager, Employer's representative) or representative (e.g. works inspector, project manager etc)
- **Payment authorisation** by the employer's project manager or contract administrator prior to payment processing
- **Payment processing** by the employer's staff and final release of payment into the contractor's account.

2. Payment certification in accordance with the provisions of the contract

Service and supply contracts make provision for monthly payment based on the value of the services or goods provided. Engineering and construction works contracts make provision for **interim payments** (commonly on a monthly basis) for works executed in terms of the contract.

Each form of contract contains specific provisions for the procedures associated with the initiation and processing of payments. Interest is payable on overdue accounts.

The standard provisions in the forms of contract endorsed by the **cidb** are as outlined below. The contract data associated with a particular contract may amend these standard provisions.

An interim payment is a payment made to a contractor prior to the completion of the works or the expiry of the defects liability period. The sum of interim payments represents a fair and reasonable estimate of the value of works at the time of assessment.

Interim payments provide contractors with the necessary cash flow to complete the works.

Interest payments on overdue accounts is fruitless and wasteful expenditure as it is "expenditure which was made in vain and would have been avoided had reasonable care been exercised"

Form of contract	Who initiates payment claim	Processing of claim	Period within which Employer pays
Supply contracts			
cidb General conditions of purchase	-	-	within 28 days of receipt of a Supplier's statement and where required, valid tax invoice.
cidb Contract for the Supply and Delivery of Goods	-	If the Purchaser disputes an amount in the invoice, the Supplier is given reasons for the disputed amount before the due date for payment. The undisputed amount is paid to the Supplier	within 42 days of receiving a valid tax invoice
cidb Supply of Goods (Short Contract)	Supplier assesses the amount due and submits each an invoice at each assessment day	If the Purchaser does not agree with an invoice submitted by the Supplier, payment is made for the agreed part of the invoice	within three weeks of receiving the Supplier's invoice.
cidb Supply Contract	Supplier assesses the amount due and submits an invoice together with supporting information	If the Purchaser does not agree with an invoice submitted by the Supplier, payment is made for the agreed part of the invoice	within 30 days of receiving the Supplier's invoice

Form of contract	Who initiates payment claim	Processing of claim	Period (calendar days) within which Employer pays
Service contracts			
cidb General Conditions of Service	-	-	within 28 days of receipt of a service provider's statement and where required, valid tax invoice
NEC3 Term Services Contract	Services Manager assesses the amount due at each assessment date and consider an application for payment submitted by the Contractor	Services Manager gives the Contractor details of how the amount has been assessed and certifies the payment within one week of the each assessment date	within three weeks of the assessment date
Construction works contracts (interim payments)			
FIDIC Short contract	Contractor submits a monthly statement to the Employer	Employer is permitted to deduct any amounts for which a reason for disagreement is given.	28 days of the delivery of the statement
FIDIC "Red Book"	Contractor is required to make application for a payment certificate to the Engineer at the end of each month, setting out the amounts which the Contractor believes that he is entitled to	Engineer verifies statements and issues interim Payment Certificate within 28 days of receipt of the Contractor's statement and supporting documents	56 days after the Engineer receives the Contractor's application for payment
FIDIC "Yellow book"	Contractor is required to make application for a payment certificate to the Engineer at the end of each period stated in the contract data, setting out the amounts which the Contractor believes that he is entitled to	Engineer verifies statements and issues interim Payment Certificate within 28 days of receipt of the Contractor's statement and supporting documents	56 days after the Engineer receives the Contractor's application for payment
GCC 2004	Contractor is required to deliver to the Employer a monthly statement for payment of the amounts that he considers due to him	Engineer verifies statements and issues interim payment certificate within 7 days to the Employer.	28 days after the Engineer issues the payment certificate to the Employer
JBCC Minor Works (Edition 4.0 of Augsut 2007)	Principal Agent issues an interim monthly certificate. Contractor co-operates and assists in the preparation of the valuation of the payment certificate.	Principal Agent issues an interim payment certificate by not later than the day of the month stated in the contract data, whether or not the Contractor provided any information	7 days after Principal Agent issues payment certificate to Contractor and Employer
JBCC Principal Agreement (Edition 5.0 of July 2007)	Principal Agent issues an interim monthly certificate. Contractor assists the Principal Agent in the preparing the claim information and assessing the amounts completed	Principal Agent issues an interim payment certificate by not later than the day of the month stated in the contract data, based on a valuation not more than 7 days prior to this day, whether or not the Contractor provided information.	7 days after Principal Agent issues payment certificate to Contractor and Employer
NEC Engineering and Construction Short Contract	Contractor assesses amount due by assessment date provided for in the contract and applies for payment.	Employer notifies contractor of corrections	3 weeks after the next assessment date which follows the receipt of an application for payment
NEC Engineering and Construction Contract	Project Manager assesses the amount due at each assessment date and may consider an application for payment submitted by the Contractor.	Project Manager gives the Contractor details of how the amount has been assessed and certifies the payment within one week of each assessment date	3 weeks from the assessment date
Professional service contracts			
NEC3 Professional Services Contract	Consultant assesses the amount due and submits an invoice at each assessment date.	Employer notifies the Consultant of any part of the Consultant's assessment which is not accepted before the due date for payment, whereupon the Consultant either corrects the invoice to reflect the agreed amount or provides further information to justify the invoice.	within three weeks of receiving the Consultant's invoice
cidb Standard Professional Services Contract	If no provisions are established in the Pricing Data, the Service Provider is entitled to render interim monthly accounts.	Service Provider is notified of any disputed amounts prior to the due date of payment. Payment is made on the balance of the invoice.	within thirty (30) Days of receipt of the relevant invoices

In **construction contracts**, different processes are provided to when **final payment** is made. The standard provisions for final payment in the forms of contract endorsed by the **cidb** are as outlined below.

Final payment is the amount due when the works have been completed or after the expiry of the defects liability period

Form of contract	Who initiates a final payment claim	Processing of final claim	Period within which Employer pays
FIDIC Short contract	Contractor provides Employer with final account within 45 days of the expiry of the notifying (defects liability) period		28 days of the delivery of the final statement
FIDIC “Red Book” and FIDIC “Yellow book”	Contractor provides Engineer with draft final statement within 56 days of receiving the Performance Certificate	Engineer verifies statement. Contractor issues to the Engineer Final Statement and the discharge within 28 days of the issuing of the draft final statement. Engineer issues Employer Final payment certificate within 56 days of receipt of draft final statement	56 days after the employer receives the Final Payment Certificate
GCC 2004	Contractor deliver final statement to the Engineer with 14 days after the issue of the Final Approval Certificate	Engineer verifies final statement and issues Final Payment Certificate within 14 days of receipt of the Contractor’s final statement	28 days after the Engineer issues the final payment certificate to the Employer
JBCC Minor Works	Principal Agent submits the final account to the contractor within 45 days of practical completion	Contractor accepts or objects to the final account within 10 days. Thereafter Principal Agent issues final payment certificate to Contractor and Employer.	7 days after the date of the final payment certificate issued by the Principal Agent to the Contractor and Employer
JBCC Principal Agreement	Principal Agent issues the final account to the contractor within 90 days of practical completion	Contractor accepts or objects to the final account with 45 days of receipt. Thereafter the Principal Agent issues final payment certificate within 7 days to Contractor and Employer.	7 days after Principal Agent issues final payment certificate to Contractor and Employer
NEC Engineering and Construction Short Contract	Contractor assesses amount due and applies for payment within one month after defects date.	Employer notifies contractor of corrections	7 weeks after the next assessment date which follows the receipt of an application for payment
NEC Engineering and Construction Contract	Project Manager assesses the amount due within four weeks of the Supervisor issuing the defects certificate and may consider an application for payment submitted by the Contractor.	Project Manager gives the Contractor details of how the amount has been assessed and certifies the payment within one week of the each assessment date	3 weeks of the assessment date

The procedures for processing of claims are similar for the **cidb** supply contracts, the **cidb** service contracts, the FIDIC Short Contract and the NEC3 Engineering and Construction Short Contract. Payment invoices, accompanied by supporting information as necessary, are generated by the contractor, based on the prices provided in the contract and the services or works completed or goods supplied. An official who is familiar with the contract, typically the official who acts as the employer’s representative in terms of the contract, needs to review the reasonableness or correctness of the contractor’s claim for payment, correct the amounts due if necessary, notify the contractor accordingly and certify the payment claim.

An agent of the employer (Service Manager, Engineer, Principal Agent or Project Manager, depending upon the text of the form of contract referred to) is appointed to administer the contract and to certify payment to the contractor in all the other forms of contract. The employer should rely on the certification of payments by such agent.

It is usually not necessary to develop specific forms for payment claims made by the contractor where the employer’s

An agent of the employer should be a person registered with a built environment profession council. Such a person is governed by a code of conduct and can be held professionally accountable for the reasonableness of such claims

The Forecasted Final Cost is an estimate of the likely cost of completing the contract. As such it includes allowances for scope changes, price adjustment, currency fluctuations, identified risks, and other contingencies.

Typically, a tender evaluation committee develops the Forecasted Final Cost. The decision to award a contract is based on this value.

A tax invoice is a document which is provided for in the Value-Added Tax Act, 1991 ("the VAT Act") to enable the vendor to claim input tax.

The VAT Act prescribes that a tax invoice must contain certain details about the taxable supply as well as the parties to the transaction.

representative certifies payment except in the case of construction works contracts. (The FIDIC Short Contract and the NEC3 Engineering and Construction Short Contract contain procedures for the adjustment of the contract price where scope changes and employer's risk occur.) A standard form for the employer's representative should be developed to ensure that records are kept regarding the previous amount claimed, the current invoice amount, the total amount claimed to date and the contract price or the Forecasted Final Cost. (If the amount claimed exceeds the contract price or the Forecasted Final Cost, authority should be obtained in terms of an organisation's procurement policy). Such forms should also indicate the due date for payment after which interest may be charged to enable the processing of payment certificates to be prioritised, and to avoid confusion where interest is to be calculated from due date to date of payment.

It is essential that specific forms for payment claims / certification be developed for the NEC3 Term Service Contract and all the construction works contracts. Such forms, in addition to reflecting the abovementioned information should, as relevant, indicate key contractual dates (start, completion and end of defects liability period), the total of prices at the commencement of the contract and the revised amount, the amount for work done to date, adjustments for scope changes and employer's risks, penalties, advance payments (see inform practice note #16), deductions made in terms of the contract, VAT etc. The forms should be designed to reflect the wording of the contract that is used and cross reference the clauses to which the items refer. Suitable supporting documentation must be attached to the form to substantiate the amounts certified. This provides an audit trail and facilitates the auditing of the certificates should this be required.

Section 20(1) of the Value Added Tax Act of 1991, (Act 89 of 1991), requires that a supplier (person supplying goods or services) who is registered as a VAT vendor issue to the recipient a tax invoice within 21 days of the date of a supply whether requested or not.

Tax invoices for amounts in excess of R3 000 must include:

- the words "TAX INVOICE" in a prominent place
- the name, address and VAT registration number of the supplier
- the name, address and where the recipient is a vendor, the recipient's VAT registration number
- the serial number and date of issue
- an accurate description of goods and/or services (indicating where applicable that the goods are second-hand goods);
- Quantity or volume of goods or services supplied
- Price and VAT

Some forms of contracts, supported by the **cidb** do not establish requirements for the submission of tax invoices together with payment certificates or statements and rely on the laws of the country regarding VAT invoices. In such cases, the employer will be liable for interest on overdue payments should a payment be held up pending the submission of a VAT invoice as:

- the employer is obligated to pay the contractor in terms of the contract; and
- the contractor is required in terms of South African law to issue a tax invoice within 21 days of the date of a statement or payment certificate to the employer.

Should the employer require that a VAT invoice be provided before payment can be made, then it is necessary to include specific clauses in the contract data to notify the contractor that payment may be delayed should the contractor fail to provide a VAT invoice.

3. Payment authorisation

Payment certification confirms that the contractor is due the amount shown in the payment certificate in terms of the contract. Payment authorisation confirms that the amount payable is within the amount authorised for the contract in terms of the employer's financial management system.

Payment authorisation as such should merely confirm that:

- the necessary paperwork for the payment has been completed;
- all the attachments to the claim for payment have been provided;
- the VAT invoices, if relevant, are valid;
- the payment claim is certified; and
- the expenditure incurred is within the approved transaction amount for the contract.

The person responsible for authorising payment first needs to perform a quality assurance check on the completeness of the documentation that is submitted for payment. Thereafter, the projected final contract amount needs to be compared with the approved transaction amount. The payment may then be authorised if the amount paid to date is within the approved transaction amount.

Where the projected final contract amount is expected to exceed the approved transaction amount, the person responsible for authorising payment needs to either obtain authority timeously to exceed this amount so as to avoid interest on late payments, or alternatively the scope of the works, services or supplies need to be reduced to keep expenditure within the approved transaction amount.

Except for the final certificate, all payment certificates in construction works contracts are interim certificates. Any errors or oversights in one certificate can be rectified in the next certificate. This is not the case with the final certificate. It is for this reason that most forms of contracts for construction works provide a longer period within which to process and agree the final payment. Consideration needs to be given to performing a basic audit on

Each organ of state is required by law to put in place a financial management system. A transaction amount is typically logged in the system at the time that a contract is awarded. This transaction amount should include allowances for the effect on the likely final amount payable to the contractor in terms of the total of prices for the works, scope changes, price adjustment for inflation, currency fluctuations, identified risks, and other contingencies. In a well structured system, authorisation should be obtained should the authorised transaction amount be exceeded.

The person responsible for authorising payment needs to co-ordinate the time frames for payment in terms of the contract with the person responsible for certifying payment.

the final account to ensure that the amounts certified are in accordance with the contract.

4. Payment processing

In order to align the payment of contractors on or before a particular day in the month, it may be necessary for an organisation to either:

- *select and include appropriate data in the standard forms of contracts to enable this to take place, or*
- *amend or vary the standard forms of contract to permit this.*

In some instances, it might be appropriate to only amend the standard time periods.

Payments that have been authorised need to be made either by means of a non-transferable cheque or an electronic bank transfer. Procedures need to be put in place to write out the cheque or to upload the payment particulars on an electronic transfer system. Such procedures need to verify that the details of the payee and the amount are correct and to sign or authorise the release of the payments.

Consideration should be given to releasing payments on a given day. This enables the process to be managed. For example if payment is released on the 28th day of each month and payment is in terms of the NEC3 Engineering and Construction Contract, the Project Manager needs to assess the works by the 7th of the month and to certify payment by the 14th of the month while the person responsible for authorising payment needs to do so by the 21st of the month to allow 7 days for processing so that payment can be released on the 28th of the month.

5. Release of retention monies

Retention amounts are deducted from the value of the interim amounts inclusive of VAT due to contractors in construction works contracts. (Retention amounts are financial arrangements between the parties to a contract and are therefore not subject to VAT.)

Some forms of contract include the release of retention monies in interim and final payments. Others make these amounts due within a specified time after the employer's agent certifies completion or the end of the defects liability period in terms of the contract.

Retention is an amount of money retained for a certain period to offset costs which may arise from the contractor's failure to comply fully with the contract

Form of contract	Release of retention amounts
FIDIC Short contract	The first half of the retention is paid by the Employer within 14 days of issuing the taking over notice. The second half of the retention is paid within 14 days after the later of the expiry of the period for notifying of defects stated in the contract data or the remedying of notified defects. The Contractor is not required to issue a statement to receive these payments. The issuing of the notice and the expiry of these periods automatically trigger payment.
FIDIC "Red Book" and FIDIC "Yellow book"	The first half of the retention money is certified for payment by the Engineer when the Taking-Over Certificate is issued. The outstanding balance of the retention is certified by the Engineer promptly after the expiry of the latest of the dates for the Defects Notification Period.
GCC 2004	The first half of the retention money becomes due when the Engineer issues the Certificate of Completion. The outstanding balance of the retention is certified by the Engineer within 14 days after the expiry of the Defects Liability Period.
JBCC Minor Works	Retention is halved after the date of practical completion and becomes 0% in the final payment certificate.
JBCC Principal Agreement	The payment reduction is 97% of the interim payment certificate issued at practical completion, 99% of the interim payment certificate issued on the date of final completion and 100% of the value in the final payment certificate.
NEC Engineering and Construction Short Contract	The amount is halved in the first assessment made after Completion and remains at this amount until the assessment day after the Defects Certificate is issued. No amount is retained in the assessment made after the Defects Certificate has been issued.
NEC Engineering and Construction Contract	The amount is halved in the next assessment made at the Completion of the whole of the works or in the assessment after the Employer has taken over the whole of the works if this is before Completion of the whole of the works. No amount is retained in the assessment made after the Defects Certificate has been issued.

6. Guiding principles for streamlined payment where an Implementing Agent is appointed

The following key guiding principles should be considered in the design of any payment systems where one organ of state implements projects on behalf of another i.e. where a Client Department appoints an Implementing Department:

- the Implementing Agent must ensure that the contractor is paid on-time **i.e. within the time frames of the contract**
- the Implementing Agent must be held responsible for monthly reporting **in an agreed format with the client**
- the procedures for payment including the preparation of VAT invoices and the certification of the payment provided in the various forms of contract must be adhered to
- the Service Delivery Agreement (SDA) between the Client Department and the Implementing Agent should address the payment arrangements clearly.

7. Funds flow between the Client Department and the Implementing Agent

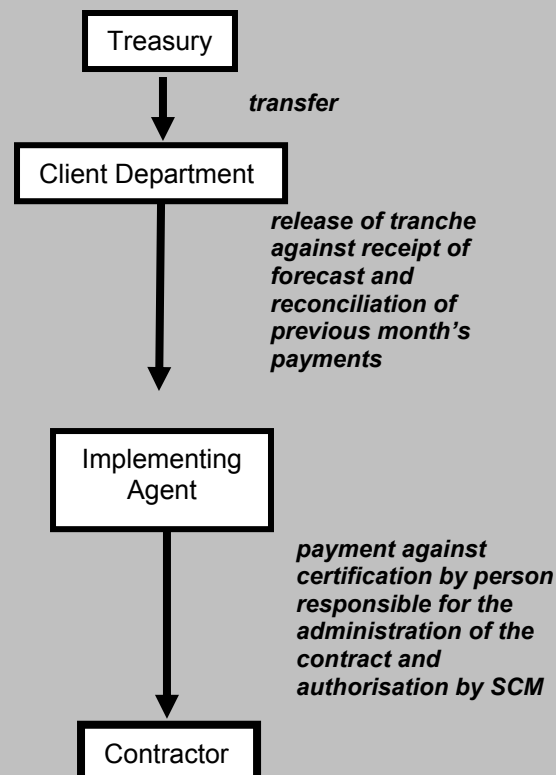
The most effective and efficient flow of funds between the Client Department and the Implementing Agent (IA) is for the Client Department to transfer funds in tranches to the IA who then pays the contractor directly. In such an arrangement:

- the Client Department will transfer the requested funds to the account of the IA after satisfying himself or herself with the payments made during the previous month.
- the process is repeated until the last month when the projects are completed and the two parties can reconcile all payments made and outstanding payments to be made.

For this arrangement to be effected, the transferred funds will need to be incorporated in the budgeting process of both the client and the implementing agent.

The activities coupled with this flow of funds, where payment is made before a month end, are as follows:

- The IA submits to the Client Department monthly forecasts of payment for the expected expenditure for that month including any retention and VAT, by the 7th of the month.
- The Client Department transfers the forecasted amounts to the account of the IA before the 21st of the month.



Forecasts should be based on the contractor's programme of work read in conjunction with the contractor's estimated cash flow in respect of each contract. Such forecasts should be prepared by the relevant Engineer / Principal Agent / Employer's representative.

We would like to hear from you about your progress, challenges and ideas.

Contact us:

E-mail: infocus@cidb.org.za

Fax: 012 343 7153

CIDB Switchboard 086 100 2432

Registers Helpdesk 086 010 3353

Registers Post Private Bag x14
Brooklyn Square
0075

CIDB Post: PO Box 2107
Brooklyn Square
0075

- The IA pays the contractors after checking and authorisation of claims by the programme or project manager.
- By the 7th day of the next month, the IA provides the Client Department with a detailed report on payments made during the previous month, attaching copies of the relevant claims as proof of payments made, as well as the forecast for the next month's payment.

The IA retains the retention monies, if any, and releases them to the contractor when required to do so in terms of the contract.

The IA is responsible for the auditing of the certificates and the reconciliation of all contractual amounts.

A formal comprehensive Service Delivery Agreement (SDA) between the client and implementing agent should be established and adhered to. Payment standards set in the SDA need to be adhered to by the implementing agent and contractors should be paid according to these standards. The client should not be responsible for these administration duties.

Some of the key advantages of this arrangement are that:

- payments can be processed quickly
- IA are fully accountable for the contractual obligations
- improved reporting by IA
- better leverage by the client department.

2001 National Treasury Guidelines on Capital Works and Acquisition of Land: Recoverable Funds

1. With effect from the 2001/2002 financial year, allocations for capital works and acquisition of land have been provided for on department budgets. The Department of Public Works however, remains responsible for the management of projects on behalf of client departments.
2. Since the introduction of the aforementioned arrangement, the National Treasury has been made aware that the Department of Public Works and client departments are experiencing certain practical problems with regard to the recovery of costs.
3. In an attempt to address these practical problems, the National Treasury has approved the following arrangements, after consultation with the Office of the Auditor-General, the Department of Public Works and certain client departments:
 - 3.1 To alleviate cash flow difficulties, advance payments must be made at the request of the Department of Public Works for projects in process.
 - 3.2 The monthly Programme for Accelerated Capital Expenditure (PACE) report together with a Z59 claim duly certified by the Chief Financial Officer of the Department of Public Works shall be deemed acceptable as the payment certificate and must be settled within 30 days.
 - 3.3 The Department of Public Works shall, for audit purposes, be responsible for the maintenance and retention of invoices and supporting documentation as per the Works Control System (WCS)
 - 3.4 The auditing of invoices and supporting documents shall only be conducted at the Department of Public Works.
 - 3.5 Claims for March 2002 which, although processed by the Department of Public Works some 15-21 days after the end of the financial year, shall be accounted for in the 2001/2002 financial year and prior to the official closure of books for that financial year.