



FINANCIAL MANAGEMENT

Transitioning from a project environment
into a Public Entity



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1. INTRODUCTION

The Gautrain Management Agency Act was enacted in 2006, five years after the initiation of the Gautrain Project, in order to establish an entity dedicated to the management and operations of the Gautrain. Before this Act, Gautrain was managed and accounted for by the Gauteng Department of Roads and Transport.

The financial management and accounting systems for a project or public entity differ significantly when compared to that of a government department.

Project financial management is characterised by a cash-based accounting system whereas an accrual system of accounting applies to public entities. The cash based method implies that the recording and accounting of transactions for revenue and expenses is only done when the corresponding cash is received or payments are made.

However under the accrual basis of accounting, expenses are matched with the related revenues and are reported when the expense occurs, not when the cash is paid.

The main difference therefore between the two systems is the timing of when revenue and expenses are recognised.

The Standards for Generally Recognised Accounting Practice (GRAP) are also applicable to the latter. The transitioning of the financial management systems for the Gautrain

from a departmental system to that of a public entity was not without its problems and this was primarily because of the differences between the two systems.

This case study examines how the financial management and accounting was carried out for the Gautrain as a project. It also focuses on how the GMA, who was solely responsible for the project, has managed the transition, discharged this responsibility and managed the financial resources in accordance with legislative prescripts such as the Public Finance Management Act (PFMA).

This case study also traces the insights, challenges and most importantly the lessons learnt during the various phases of the development of the Gautrain.

2. PROVIDING CONTEXT

The then Gauteng Department of Roads and Transport (Gautrans) delegated Mr Jack vander Merwe, who was then the Head of Department (HoD), to be Project Manager and Province Representative for the Gautrain Project. Jack then appointed a team of experts referred to as the Provincial Support Team (PST) to help the department carry out the delivery work for the Gautrain Project.

The National Treasury Division of Revenue Act (DORA) requirements for reporting had to be strictly adhered to, because the Gautrain project

was a PPP Project under the department. In terms of the division of revenue,



In terms of the division of revenue an explicit revenue sharing formula is used to divide the provincial equitable share between the nine provinces – this is called the horizontal division” (National Treasury).

It directs funds to provinces based on their demographic and economic profiles, in terms of fulfilling demand for basic services within the provinces. The DORA provides for the equitable division of revenue raised nationally among the national, provincial and local spheres of government for the financial year and the responsibilities of all three spheres pursuant to such division; and to provide for matters connected therewith” (quoted from the Act). Section 10, Part 2 of the Division of Revenue Act 2 of 2006, made provision for the Gautrain Rapid Rail Link Grant.

In terms of the DORA, conditional grant requirements are that regular reporting on the status of the Project needs to be done before any funds can be released. Therefore, reporting on the Gautrain project was done monthly, quarterly, and as per Project milestones. The other requirement was that the delegation of authority for the Project had to be clarified upfront. Delineation of duty and clear lines of

responsibility and reporting are extremely important in these types of projects. For a project of such magnitude as the Gautrain, which involved large-scale infrastructure development and construction, an Independent Certifier (IC) had to be appointed upfront.

The role of the IC was to ascertain that all work that that concessionaire report needed to be completed was indeed completed, and to a satisfactory standard.

This independent verification enabled certification of work, confirming that the funds for the payment of the completed project milestone could be released.



Table 1. Gautrain Construction Project Role players

DESIGNATION	ENTITY	ROLE
Client	Province/GMA	Project Owner
Contractor	Concessionaire/BCC	Project Implementer
Independent Certifier (IC)	ARUP	Project Independent Certifier for completed works

3. PAYMENT PROCESS AND RECORDS MANAGEMENT DURING THE PROJECT PHASE

It's well understood that Records Management is key in all phases of the Project, but it was particularly crucial for the IC to keep project documentation of all work that had been certified as complete.

This was important for accounting, payments and

auditing at a later stage. It was also crucial for any other investigations or dispute matters, as they later occurred in the case of the Gautrain. The standard practise in management of these types of projects is to set up payment mechanisms, and include payment terms and/or payment schedules as part of the contract.

In the case of the Gautrain, the payment terms were negotiated, agreed to

and incorporated into the Concession Agreement (CA). It's important to note that large scale projects with large cash injections or financial investment require the strongest of financial management systems and protocols.

The CA made provision for issuing of penalties should payments be received late from the Province.

It was therefore critical for



the Province to manage this function carefully and implement a sound cashflow management system to avoid these penalties. It should be noted that the construction phase of the Gautrain was happening parallel to the construction of stadiums for the 2010 FIFA World Cup. The demand on cash on the state for these two large infrastructure projects was quite intense. As a result Province and the National Treasury had to come up with strategies to mitigate the risk of possible late payments, in order to manage cash flow better and avoid any penalties.

Reporting was done quarterly to Treasury and the Province, and this is still the case to date. The IC submitted a report for payments to the Gautrain Project Office on the 25th day of each month. The Gautrain Project Office under the management of the PST had 10 days to verify documentation for payments and to make the payments.

The PST assisted the Gautrain Project financial management function by bringing in qualified, experienced and skilled personnel.

The financial model for the Gautrain includes payment of a Patronage guarantee. In order to ensure that the Patronage Guarantee was paid correctly, a set of payment dry runs was done between the Province and the Concessionaire. Quality control mechanisms were implemented to ensure

that the financial and technical documentation was verified to allow for payment.

4. TRANSITIONING TO A PUBLIC ENTITY

The first GMA annual and audit reports were released in 2009. The GMA has therefore been a fully-fledged entity since that year, making it a total of eight years up to where we are currently in 2017.

The GMA has received a clean audit for at least five of those years, meaning that our “financial statements are free from material misstatements and there are no material findings on reporting on performance objectives or non-compliance with legislation”. The PST, among other responsibilities, also took charge of the financial management of the Gautrain Project on behalf of the Province. The efficient management of finances by the PST team resulted in a smooth transition to the GMA.

This smooth transition could also be attributed to the fact that most of the finance team members at PST were retained by the GMA. However, this was not achieved without challenges:

- In project mode, there was just a need for payments reporting and certification.
- In an entity, setup policies and procedures had to be developed. The need to adhere to PFMA, Treasury regulations, the GMA Act and GRAP was paramount.
- Also, the Assets (Gautrain) were accounted for under the



Department of Roads and Transport. This was because the CA was signed between Province (represented by the Department) and the Concessionaire.

However, with the establishment of the GMA this meant that assets had to be transferred to the GMA to the value of ± R35 billion.

Initially the main groups or categories of payments that the GMA as a new entity had to deal with included:

- Milestones (Project Milestone payments)
- Variations (Project variation costs and payments)
- Land (Land Acquisition costs)
- PST (Consulting fees)
- Board members (Board fees and capacity building costs)

5. CHALLENGES

Below are some of the challenges that were experienced by the GMA during the transition:



Non-compliance to the PFMA.



Lack of sufficient funds to meet supplier payments and milestones, plus late payment penalties.



Insufficient human capacity to deal with the financial management workload, particularly the processing of large volumes of payments.



A complex foreign currency payment process that had to be done via the South African Reserve Bank (SARB), as they took responsibility for the currency fluctuation risk.



A lack of understanding and awareness of Treasury regulations and the PFMA by some personnel led to issues of non-compliance.



Lack of adequate forecasting mechanisms for cash flow management.



Lack of knowledge and experience of the financial implications of disputes that arose between Province and the Concessionaire, during the development phase.



A payment schedule with agreed payment dates, which was also linked to milestone completion dates, meant that **no advance payments** could be made, even though milestones were completed earlier.

6. WHAT WORKED WELL?

There were also a number of things that worked well:

Experienced and skilled finance personnel at PST made the transition easier.



Retaining these skilled personnel when moving from the PST to the GMA was vital.



The process had a less bureaucratic approval process in a project environment.



Strong project leadership and efficient decision-making eased the process.



Well thought out project processes and implementation by a knowledgeable client.



A good financial system was already in place.



7. LESSONS LEARNT

In order to benefit from these experiences and changes, it's important to address which lessons the GMA learned along the way:

Independence

- The Independent Certifier must be independent and knowledgeable.
- Cash flow forecasting must be done as part of the project plan.
- Contractual structuring of financial payments is very key.
- Issues raised on site must be dealt with promptly to avoid disputes later.

Financial Management

- Stringent financial management is vital.
- Relationship with the Auditor General must be established to determine requirements, so that things are done correctly the first time.

Cash Flow Management

- Payment for milestones reached, instead of for each project activity, allowed for large sum invoices to be paid instead of separate individual invoices.

In total the GMA has gone through eight auditor general audits that were all unqualified, meaning that the auditor generally found no malice in the reports. For the

last five consecutive years the GMA has been a proud recipient of the Auditor General clean audit award. Even though the first three audit reports were unqualified, there were notably some teething problems and financial management compliance challenges.

The GMA had to attend to these quickly by introducing policies and procedures in line with the PFMA. Governance principles for financial management were also developed.

The subsequent success of the GMA (these clean audits) can be attributed to a number of factors:

7.1 Leadership

The visionary, exemplary

and strategic leadership of Executive Authority (MEC), Accounting Authority (GMA Board) and the Accounting Officer (CEO) contributed significantly.

7.2 Governance

Adherence to policies and compliance with relevant legislation e.g. PFMA has been a large factor in the GMA's success. The establishment of applicable processes has also contributed. CFO delegations of authority were properly managed. Insights and knowledge were also shared by various entities within the business.

7.3 Audit

Close collaboration with internal and external audit teams and the crafting of the audit strategy in consultation with all relevant parties, was also important.

7.4 Performance & Strategy

Too many targets in the past have now been streamlined for a better strategic focus. The involvement of internal audit in performance management ensures that targets are met and evidence is available when needed. The sharing of overall organisational performance by all business unit heads also contributed to the success.

7.5 Organisational support

Advisory and support role approach from the CFO

delegations of authority were properly managed. Insights and knowledge were also shared by various entities within the business.

7.6 Skilled Personnel

Competent, dedicated and committed staff members are always integral to the success of processes and the organisation as a whole.

8. LOOKING FORWARD

- ① Planning for the Gauteng extensions and expansions of the Gautrain will require the financial management of the organisation to be prepared. Having learnt lessons from the development of the current Gautrain, below are some items to consider:
- ② Project versus corporate environment: different skills sets are required for project and corporate environments.
- ③ Communication and stakeholder management: issues need to be attended to promptly by holding regular meetings. There also need to be dedicated personnel for segments of payments/work /stakeholders.
- ④ Controls: The delegation of authority needs to be properly structured, as does the delegation of authority peculiar to that of the project. There also needs to be extra certification of work done.
- ⑤ Financial management controls: Technical certification is crucial.

Resource Allocation: There needs to be dedicated personnel for the project or a standing approach for project items. Project specification personnel for the supply chain and allocation of responsibilities for variations is also important.

- ⑥ Legislative Provisions: The Amendment of the Gautrain Act is geared towards developing the GMA into a revenue generating entity, which could also be in a position to raise funding.

9. CONCLUSION

The GMA has successfully managed the transition and this is evident by the clean audits received to date. This would not have been possible without good leadership, the implementation of effective financial management systems, the introduction of policies and the entrenching of a good governance and compliance culture.





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