

May 2020

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## Acknowledgements

Payment delays have been considered as a major risk by private sector service providers working with urban local governments. Based on the discussions in the in the Municipal strengthening Task Force of the NFSSM Alliance, it was agreed to review and explore measures to mitigate this risk. This paper has been prepared in response.

It provides a brief overview of ongoing efforts and innovative approaches that can be taken up to address the issue of delayed payments. It is hoped that these will be discussed further and used to encourage greater private sector engagement with urban local governments for providing basic services such as water, sanitation and faecal sludge and septage management.

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## **Addressing Risks of Delayed Payments by Urban Local Bodies**

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Delayed payments from public agencies have been cited as one of the major problems by private enterprises. Often this is the reason for service providers to stay away from entering into a contract with urban local bodies (ULBs).

For Faecal Sludge and Septage Management (FSSM), ULBs engage private enterprise to provide various services such as desludging, Faecal Sludge Treatment Plant (FSTP) construction and its operation and maintenance. ULBs often contract out other sanitation services like, drain cleaning, Solid waste collection and transportation, maintenance of community and public toilets. In metro cities, such tasks are contracted out to large private enterprise, but in smaller cities it is the small and medium enterprises that are given such contracts. These enterprises have voiced concerns around risk of delayed payments by ULBs. The delayed payments mean that the enterprises have to raise working capital till the payments are released.

We review below some efforts that have been made to address this issue, as well as some innovative ideas that can be taken up in dealing with the delayed payment risks.

### **1. Escrow account mechanisms**

Escrow account mechanism can be used to ensure availability of funds for timely payments to a private service provider in a contract. For example, in scheduled desludging operation in Maharashtra, an escrow account is created between contractor, local government and a bank through a tripartite agreement. It is mandated to maintain a minimum three months' payment which is called 'Contract Fees Reserve fund' for the private operator in the escrow account. Apart from this, it is also mentioned that private operator will get interest payment in addition to invoice amount, if payments are delayed by more than three months.

However, in practice it is observed that even with the escrow account, payments are often delayed, owing both due to a lack of timely submission of bills as well as due to a lengthy process and time taken by the local governments for bill clearance. It is possible to resolve this by adding other clauses in the contract.

### ***a. Automatic payment clause***

In STP construction tender, UP Jal Nigam has also used an escrow account mechanism. However, this is more stringent with automatic payments after 10 days of issuance of bill by a private operator. As per this tender: “If, within 10 days from the date of receipt of an Invoice, the Jal Nigam does not dispute an Invoice, then the Invoice shall be deemed to have been accepted by the Jal Nigam, and the Concessionaire shall have the right to issue instructions to the Escrow Bank (with a copy to the Jal Nigam and NMCG) to release the amounts specified in the Invoice, upon the expiry of the 10-day period. Any such instruction issued by the Concessionaire to the Escrow Bank shall be accompanied with the Invoice raised by the Concessionaire for the relevant Payment Milestone”. Such mechanism could be also tried for local government contracts. Clearly, the parastatal or the ULB may use a delay tactic by raising frivolous queries. Thus, it would be useful to assess the extent to which this mechanism has been successful.

### ***b. Payment guarantee by local government***

Similar to performance guarantee which private sector provide with tender agreement, there can be a clause that local government should also provide payment guarantee to private operator. Such bank guarantee by local government can be used by private operator in case of delayed payments by more than one-two months or as specified in tender document.

## **2. Two-part payment (fixed and variable / performance based)**

One can address delayed payment by adding a two-part payment clause in tender documents, wherein payment to private operator can be done in two parts, a) one is fixed part- which is released as soon as bills are submitted by private operators and b) other is variable/ performance based- which is released only after reviewing the actual performance of private operators as per target specified. This will help private operator to get part payment on time so that they can have some working capital to continue operations. This will safeguard interest of both local governments and private operators.

Expenditure Management Committee was constituted by Government of India, headed by Dr. Bimal Jalan in 2015. One of their recommendations was “Payments delays impact the bid value as this is factored into the bid by way of an increase in interest carry cost. It is learnt that Delhi Metro Rail Corporation has instituted a system whereby 75% of all running bills are released with 7 days of submission, without a detailed check on the claim. The balance is released after the claims are scrutinized as per procedure. This system is stated to have helped both in getting more competitive bids and in speedier execution, as cash flow is a critical requirement in a

project. It is recommended that this practice of releasing a specified proportion of the running milestone payments, within a week of the bill being submitted, could be instituted in other large projects as well. If required an enabling provision may be incorporated in the special conditions of contract”<sup>1</sup>.

### 3. Specifying detailed bill clearance mechanisms in contracts and backed by an online bill monitoring system

One of the key reasons for the delay in payment is also the lengthy departmental procedures and clearances that government follows to clear payments. it would be helpful to clearly specify the detailed steps in the payment process, (e.g. date by which invoice should be submitted, and steps required for its clearance in the system. It must also specify the minimum /maximum number of days for each step for any bill to be approved and paid by the local government) in the tender document. This will give a clear idea to the private enterprise on the process of payment and the likely time that it could take.

The following illustration in Box 1 shows the process for bill clearance followed in a typical small ULB in Maharashtra for a bill submitted in the sanitation department.

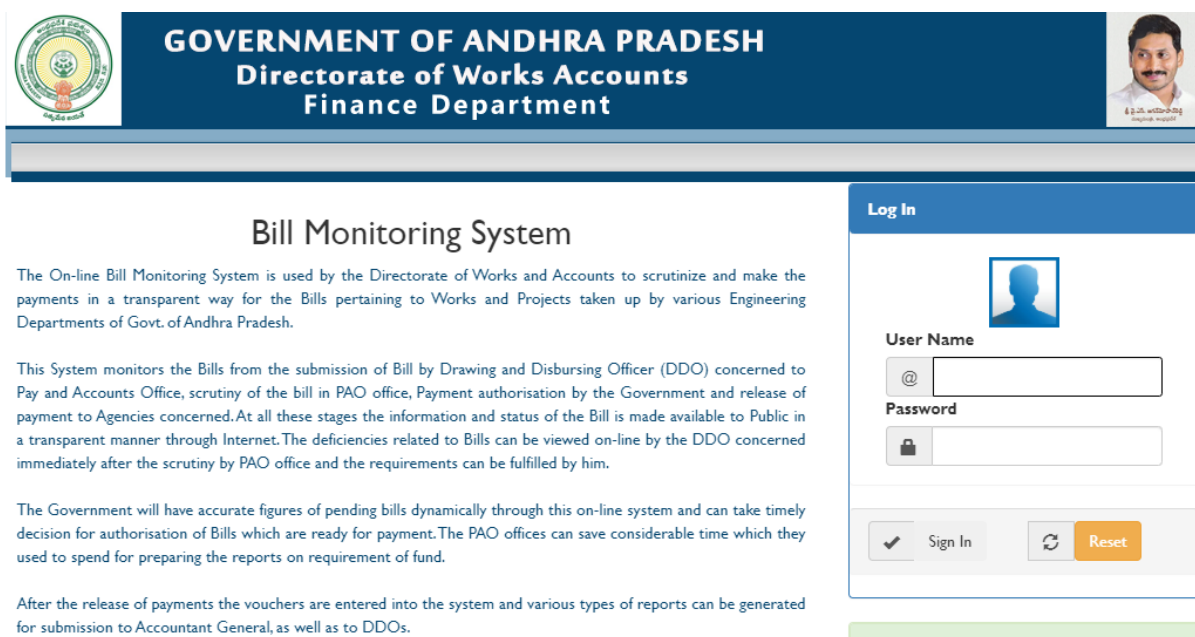
<b>Box-1 Payment process in model scheduled desludging tender of Maharashtra</b>		
	<b>Description</b>	<b>Average number of days</b>
1	Bill submitted by private contractor-ULB inward department	1 day
2	Bill submitted from WMC inward department to concerned Sanitary Inspector in the Sanitation Department (Role of SI is to check the bill, visit the site for random checking, make report for CO and sign form 64)	XX days
3	Bill forwarded to Chief Officer of council (along with report/ remarks by SI) - In case of query it is sent back again to SI - If there are no queries, then bill is forwarded to accounts department by CO	XX days
4	Accountant checks the bills. If found correct, signs on form 64 sends back to CO	XX days
5	After receiving signed form 64 from Accountant, CO signs on form 64 and sends to accountant	XX days
6	Accountant sends bill to President for approval and signature on form 64	XX days
7	After receiving signed form 64 from President , Accountant prepares letter/cheque for private operator and sends to CO for final signature	XX days
8	CO signs the letter for payment/cheque and sends to bank /gives it to private operator	XX days
<b>Total number of days for payment process</b>		<b>15~30 days</b>

*Source: Model Service contract for scheduled emptying of septic tanks in the city; Government of Maharashtra*

<sup>1</sup> As per recommendation number – 76 under public procurement section, Recommendations of Expenditure Management Committee formed by GoI and headed by Dr. Bimal Jalan, 2015

Such provisions in these contracts need to be backed by transparent bill monitoring systems. This will enable all information and status of bill payment to be made available on an online platforms. Such mechanisms have been initiated by Government of Andhra Pradesh<sup>2</sup> and Government of Telangana<sup>3</sup>. This is currently used by various engineering departments through their e-governance platforms.

**Box-2 Online bill monitoring system of GoAP (<https://dwabms.apcfss.in/>)**



**GOVERNMENT OF ANDHRA PRADESH**  
**Directorate of Works Accounts**  
**Finance Department**

### Bill Monitoring System

The On-line Bill Monitoring System is used by the Directorate of Works and Accounts to scrutinize and make the payments in a transparent way for the Bills pertaining to Works and Projects taken up by various Engineering Departments of Govt. of Andhra Pradesh.

This System monitors the Bills from the submission of Bill by Drawing and Disbursing Officer (DDO) concerned to Pay and Accounts Office, scrutiny of the bill in PAO office, Payment authorisation by the Government and release of payment to Agencies concerned. At all these stages the information and status of the Bill is made available to Public in a transparent manner through Internet. The deficiencies related to Bills can be viewed on-line by the DDO concerned immediately after the scrutiny by PAO office and the requirements can be fulfilled by him.

The Government will have accurate figures of pending bills dynamically through this on-line system and can take timely decision for authorisation of Bills which are ready for payment. The PAO offices can save considerable time which they used to spend for preparing the reports on requirement of fund.

After the release of payments the vouchers are entered into the system and various types of reports can be generated for submission to Accountant General, as well as to DDOs.

**Log In**

User Name  
@

Password  
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☐ Sign In

Some large Municipal Corporations such as the Ahmedabad Municipal Corporation have also introduced e-billing monitoring systems through which billing process is monitored from inward of bills to clearances through various departments to the final bill payment. It needs to be assessed whether these systems are transparent and whether they provide alerts on undue delays, and related complaints.

Such mechanisms should not be limited to only state departments and large corporations, but could also be extended to contracts by all ULBs, including small and medium local governments. For the small and medium cities, support can be provided to use state or district level online platforms.

<sup>2</sup> <https://dwabms.apcfss.in/>

<sup>3</sup> <https://dwabmstg.cgg.gov.in/bms/#>



#### **4. A Risk Mitigation Fund for SMEs (with Philanthropy /CSR funds)**

A risk mitigation fund can be set up to enable private contractor to access loans at low interest rates for meeting working capital requirements when payments are delayed. Such a fund can be set up with a combination of public allocations and grants from CSR or philanthropy funds.

Access to working capital loans at no or low interest rates can help mitigate risks of delayed payments. Appropriate arrangements can be made to ensure that once payments are made by the ULBs, loans will be directly repaid through the escrow mechanisms. The possibility of using intercept mechanisms using state grants to ULBs as security, as has been done successfully under the Tamil Nadu Urban Development Fund for its loans to ULBs.

#### **5. Mobilization Advance**

Mobilization advance or secured advance may also reduce private sector working capital needs. Generally, mobilization advance is given only in large and capital-intensive works. Also, urban local governments generally do not provide mobilization advance to private contractor. The mobilization advance can be provided as 10% of contract value and such advance can be deducted from running bills or in the final bill.

#### **6. Trade Receivables Discounting System (TReDS) Platform**

Another idea that has gained popularity in recent times is invoice discounting. Invoice discounting accelerates payment against approved bills by agreeing for a cash discount directly to the buyer or through a financier, who in turn collect the full amount.

In 2015, RBI allowed setting up of the Trade Receivable e-Discounting System to help discounting and settling of invoices, which render factoring services in case of delayed payment. This is a financial arrangement wherein a seller recovers an amount of the sales bill from a financial intermediary, after paying a discount/fee, before it is due. Three TReDS exchanges — M1, RXIL and ATREDS — have been set up since then. In 2017-18, all the three exchanges put together handled transactions of Rs 300 crore. However, this is limited to only companies registered under the Companies Act 2013 and reporting a turnover of over Rs 500 crore. It would be useful to explore a similar platform for small and medium sized private players.



**Box-2: Trade Receivables Discounting System (TReDS) Platform (<https://www.m1xchange.com/>)**

The RBI also introduced an online platform, TReDS, in March 2014 to facilitate discounting of bills and invoices of MSME suppliers. This is a financial arrangement wherein a seller recovers an amount of the sales bill from a financial intermediary, after paying a discount/fee, before it is due. Receivables Exchange of India Ltd (RXIL), the first TReDS platform, was incorporated on February 26, 2016.

This system involves three parties—MSME suppliers, corporate buyers and financiers. The financier discounts the invoice after the corporate buyer accepts the invoice and bills uploaded by the MSME supplier. However, this is a somewhat lengthy process because it involves many stages and interactions between the three parties. Further, the discounting and financing charges are borne by the MSME suppliers, reducing their earnings. This discourages many MSMEs from using the TReDS portal and forces them to approach informal financiers for invoice discounting that allows immediate payment.

Further, as per the November 2, 2018, notification by the MSMEs ministry, only companies registered under the Companies Act 2013 and reporting a turnover of over Rs 500 crore (and all Central Public Sector Enterprises), can board the TReDS platform. This ends up excluding many MSMEs.

*Source: Article on Government's measures to resolve the Delayed Payment issues of MSMEs on November 7,*

In the Union Budget 2020-21, it was announced that “An app-based invoice financing loans product will be launched soon, which will obviate the problem of delayed payments and consequential cash flow mismatches for the MSMEs. Necessary amendments will be made to the Factor Regulation Act 2011 to enable Non Banking Financial Companies (NBFCs) to extend invoice financing to the MSMEs through TReDS thereby enhancing the economic and financial sustainability.<sup>4</sup>” Such measures by Government of India may further alleviate the problem of delayed payments.

## **7. Delayed payment monitoring portal – MSME Samadhan**

Government of India, through its Micro Small and Medium Enterprises Development (MSMED) Act, 2006 has added a provision related to delayed payments to Micro, Small and Medium Enterprises (MSMEs). As mandated under this act, all the states/Union Territories in India have constituted Micro and Small Enterprise Facilitation Council (MSEFC) for the settlement of disputes on delayed payments. The buyer is liable to pay a monthly compound interest to the supplier at three times the bank rate notified by the Reserve Bank of India (RBI) if the payment is not made within 45 days of the day of acceptance of the goods/service or the deemed day of acceptance.

<sup>4</sup> Budget 2020-2021; Speech of Nirmala Sitharaman, Minister of Finance, February 1, 2020; Page-26-27 available at [https://www.indiabudget.gov.in/doc/Budget\\_Speech.pdf](https://www.indiabudget.gov.in/doc/Budget_Speech.pdf)

However, not many small and medium sized private players have opted for this route for the fear of losing out on future contracts<sup>5</sup>.

To empower micro and small enterprises to directly register cases relating to delayed payments by government bodies, the MSME ministry has also launched a delayed payment monitoring portal, 'MSME Samadhaan'<sup>6</sup> in 2017. However, of the 39,256 applications received on the portal, only 3132 were resolved by MSEFC, according to the data available on the portal. This is possibly due the limitation imposed on claimants.

Currently, only micro and small enterprises (MSEs) having Udyog Aadhaar Number (UAN), are eligible to apply at the portal. Medium enterprises are deprived access. The expert committee on MSMEs formed by RBI recommended that "ambit of facilitation council (MSEFC) may be extended to medium enterprises also". It was also observed by the committee that MSE borrowers lack awareness about Samadhaan portal and hence there is a need to publicize the portal amongst MSMEs. Also as the settlements of cases on the portal seems to have been low, more acceleration is required on resolving cases on faster pace. The committee also recommended that "there is a need to increase the number of MSEFCs particularly in larger states, so as to meet the time specified for resolving cases".<sup>7</sup>

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<sup>5</sup> <https://samadhaan.msme.gov.in/WriteReadData/DocumentFile/MSMED2006act.pdf>

<sup>6</sup> <https://samadhaan.msme.gov.in/>

<sup>7</sup> Report of the Expert Committee on Micro, Small and Medium Enterprises under chairman U K Sinha, June 2019 Section 4.3.3, Page 21-22 available at <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/MSMES24062019465CF8CB30594AC29A7A010E8A2A034C.PDF>

## Annexure 1

### Delayed payment clauses extracted from different FSTP/STP tender documents

#### 1. As per STP tender of UP Jal Nigam (under HAM model)- under Escrow account mechanism agreement

If, within 10 days from the date of receipt of an Invoice, the Jal Nigam does not dispute an Invoice, then the Invoice shall be deemed to have been accepted by the Jal Nigam, and the Concessionaire shall have the right to issue instructions to the Escrow Bank (with a copy to the Jal Nigam and NMCG) to release the amounts specified in the Invoice, upon the expiry of the 10-day period. Any such instruction issued by the Concessionaire to the Escrow Bank shall be accompanied with the Invoice raised by the Concessionaire for the relevant Payment Milestone.

*Source: Varanasi STP tender document, Schedule 3: Format of the Escrow Agreement, page-5*

#### 2. As per HAM tender for FSTP construction Andhra Pradesh

**Delayed Payments** -The Parties hereto agree that payments due from one Party to the other Party under the provisions of this Agreement shall be made within the period set forth therein, and if no such period is specified, within 30 (thirty) days of receiving a demand along with the necessary particulars. Unless and otherwise specified in this Agreement, in the event of delay beyond such period, the defaulting Party shall pay interest for the period of delay at the rate of 10.75% (ten point seven five per cent), and recovery thereof shall be without prejudice to the rights of the Parties under this Agreement including Termination thereof.

Unless and otherwise specified, any interest payable under this Agreement shall accrue on a daily basis and shall be compounded on the basis of quarterly rests.

*Source: Request for proposal For Setting up of Faecal Sludge and Septage Treatment Plants (FSTPs) in urban local bodies of Andhra Pradesh on design, build, operate & transfer (DBOT hybrid annuity) basis; Swachha Andhra Corporation (SAC), April 2018, Clause 37.3, page- 69*

#### 3. As per Odisha FSTP tender

Preparation of bills: The Contractors will submit their bills every month in the M. Book format for the Quantity only of the relevant running bill duly signed. This will be treated as claim of the Contractor to consider payment every month. The Contractor shall submit their bills to the Executive Engineer or any of his subordinate officer under his control as directed by the Executive Engineer. **The Executive Engineer shall be responsible to**

**scrutinize and make payment to the Contractor within 15 days from the date of submission of bills by the Contractor concerned.**

*Source: ORISSA WATER SUPPLY AND SEWERAGE BOARD, BID DOCUMENT, 'Construction of Septage Treatment Facility in Bhubaneswar City in Khordha District, Odisha' on lump sum Contract Bid ID No. 03 / PMC / OWSSB / 2016-17; Clause 43.1*

#### **4. As per scheduled desludging tender of Maharashtra**

Delayed payments: The ULB will be liable to pay the due amount with a 5% p.a. interest to the Contractor if dues are not paid for completed work for more than 3 months.

Monthly payment will be made to the contractor against submission of receipt (provided in Annexure 2) and report on number of septic tanks emptied as per the monthly target and discharged it at the designated treatment plant. If the contractor fails to submit this, proportionate payment would be deducted. The accepted tender cost will be divided by total length of contract period i.e. 36 months for the purpose of deriving monthly fees. The contractor must submit the monthly bill along with form 64 (annexure- 3), monthly report on number of septic tanks emptied as per the monthly target (Annexure-2) and forwarding letter to the council office by 5<sup>th</sup> of every month. The ULB will open an escrow account in a nationalized bank to ensure timely monthly payment to contractor. This account will have a deposit equal to at least three months of payment. The contractor's bill will be processed after ULB's inspections and as per billing process of the council given in annexure-4. The payment process will take at least 15-20 days from the date of submission of bill.

*Source: Service contract for scheduled emptying of septic tanks, Wai city"; Government of Maharashtra, Clause 22, page-9*

#### **5. As per UP FSTP tender**

Invoices - At the end of each Billing Month, the Contractor shall submit to the Authority an invoice (each, a "Contractor Invoice") in the form set out in Schedule K (Form of Invoice) showing the computation for the Septage Management Fee and stating the total amount due and payable from the Authority for the previous Billing Month.

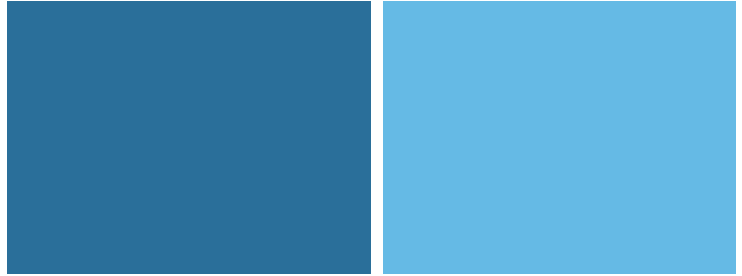
Payment Terms - The Authority shall pay the amount due in each Contractor Invoice within (30) Days after the date of receipt by the Authority of such invoice. If the last day for payment is not a Business Day, then payment shall be made on the next Business Day.

*Source: Department of Urban Development Government of Uttar Pradesh (GoUP); Septage Management Project (FSTP with Collection and Transport -32KLD) Under Design, Build, Operate & Transfer Model (DBOT) for Uttar Pradesh State; Volume 1: Business Case; August 2019 Clause 8.4, page-39*

**6. As per highway construction model concession agreement (under HAM model)**

Delayed payments : The Parties hereto agree that payments due from one Party to the other Party under the provisions of this Agreement shall be made within the period set forth therein, and if no such period is specified, within 30 (thirty) days of receiving a demand along with the necessary particulars. Unless otherwise specified in this Agreement, in the event of delay beyond such period, the defaulting Party shall pay interest for the period of delay calculated at a rate equal to 4% (four per cent) above the daily average Bank Rate, and recovery thereof shall be without prejudice to the rights of the Parties under this Agreement including Termination thereof. Unless otherwise specified, any interest payable under this Agreement shall accrue on a daily outstanding basis and shall be compounded on the basis of quarterly rests.

*Source: Public Private Partnership in Highway Development; MODEL CONCESSION AGREEMENT for Hybrid Annuity Project, GOI, Clause 41.4, page- 104.*



### About C-WAS

Center for Water and Sanitation (C-WAS) at CEPT University carries out various activities – action research, training, advocacy to enable state and local governments to improve delivery of services. In recent years C-WAS has focused our work on urban sanitation. Indicators are developed for measuring on-site sanitation and a framework for citywide sanitation planning. C-WAS also supports cities in implementing city sanitation plans that focus on making cities open defecation free (ODF) and managing their faecal sludge and septage (FSSM). In support of these efforts, the team is also working on developing innovative sanitation financing mechanisms.

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