



Advance Payments in the Swiss Contribution

8th July 2009

1 Background

Several National Coordination Units (NCU) have raised the question of how to deal with advance payments to Executing Agencies (EA) in the framework of their respective Contribution Programmes. It has become evident from these discussions that i) the differentiation of the terms “advance payment” and “prefinancing mechanism” is unclear, and ii) that a better understanding of the relevance of advance payments for different types of activities within the Contribution Programmes is required. The present note aims at clarifying both issues and describes the application of advance payments.

2 Advance payment vs. prefinancing mechanism

2.1 Prefinancing mechanism

The prefinancing mechanism is anchored in Annex 2 of the Framework Agreements between the Swiss Federal Council and the Governments of the respective contribution partner countries. The implication of this section is basically that Switzerland will *not directly settle an invoice presented by* an Executing Agency (submitted to the NCU in the form of payment claims). This will be done by the respective Paying Authorities. Switzerland will then, based on a reimbursement request of the Paying Authority, pay the corresponding amount to the account as defined in the Framework Agreement. In other words, Switzerland will only reimburse what has already been paid for by the partner countries before. The prefinancing mechanism applies to all payments occurring during the implementation of all programmes and Projects, regardless of what is subject to payment.

2.2 Advance payments

a) *Advance payments for NGOs as Executing Agencies*

Switzerland reimburses advance payments to NGOs as Executing Agencies in the Cooperation Programme under the following four conditions:

- The Executing Agencies with NGO status have to submit an application for an advance payment to the NCU;
- the advance payment does not exceed 20% of the overall Project budget;
- the advance payment does not exceed 50% of the current year's Project budget; and

- a final payment of minimum 5% of the overall Project budget will be paid not before the reception of the Project completion report.

These rules shall be communicated in the related calls for proposals. The disbursement schedule will be adjusted on case-by-case basis.

b) Block Grants

Within Block Grant Schemes in conformity with Annex 3 of the Framework Agreement, Switzerland, in general, *reimburses* advance payments to the Intermediate Bodies. Such advance payments are possible for the capital of the related fund as well as for the management costs. The conditions for these advance payments will be agreed on case-by-case basis in the set-up of the Project and stipulated in the respective Project Agreement. Moreover, NGOs and other institutions as final recipients of the Block Grant can be granted similar conditions.

c) Advance payments for regranting schemes and private equity Projects

In general, Switzerland *reimburses* advance payments for institutions that are managing regranting schemes and private equity Projects. Such advance payments are possible for the capital of the related fund as well as for the management costs. The conditions for these advance payments will be agreed on case-by-case basis in the set-up of the Project and stipulated in the related Project Agreement. To the institutions as final recipients of these regranting schemes and private equity Projects similar conditions can be granted.

d) Advance payments for research Projects

Switzerland *reimburses* advance payments to institutions that are executing research and academic exchange Projects under the following four conditions:

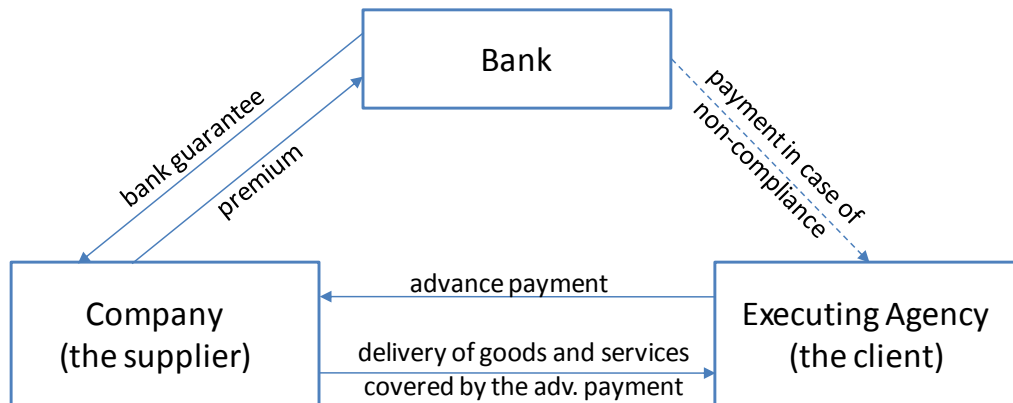
- The concerned institution has to submit an application for an advance payment to the NCU or the managing institution of the research programme respectively;
- the advance payment does not exceed 10% of the overall Project budget;
- the advance payment does not exceed 50% of the current year's Project budget; and
- a final payment of minimum 5% of the overall Project budget will be paid not before the reception of the Project completion report.

e) Advance payments for supply contracts

Advance payments are common practice in many Projects, particularly in the field of infrastructure and health. Projects requiring an advance payment usually cover one or several *supply contracts* with one or several companies. These contracts are the result of a procurement procedure according to the applicable laws and regulations.

In these contracts, the Executing Agency will be *the client*, whereas the contracted company will act as *the supplier*. The client and the supplier will, in their supply contract, agree on milestones which trigger payments to the supplier. It is a common practice for clients to disburse an advance payment to the supplier. The main justification for such an advance payment is to provide the supplier with the necessary liquidity to cover his upfront costs such as i) investments in manufacturing plants, ii) the purchase of raw materials, iii) the covering of salaries, and iv) for payments to subcontractors. Such advance payments usually amount to about 20% of the total contract price.

By paying an advance payment to the supplier, the client faces considerable risks. The supplier might not deliver according to what was agreed in the terms and conditions of the contract, or he might even declare bankrupt. In such a case, the advance payment would enter the bankrupt's assets and at least some of the corresponding amount would be lost. Usually, the supplier is therefore requested to issue a *bank guarantee* from a trusted bank, to cover the risks mentioned above. In case of non-compliance with the supply contract, the client will trigger the bank guarantee and immediately receive the agreed amount from the bank. The mechanism of advance payments and bank guarantees is described in the following chart.



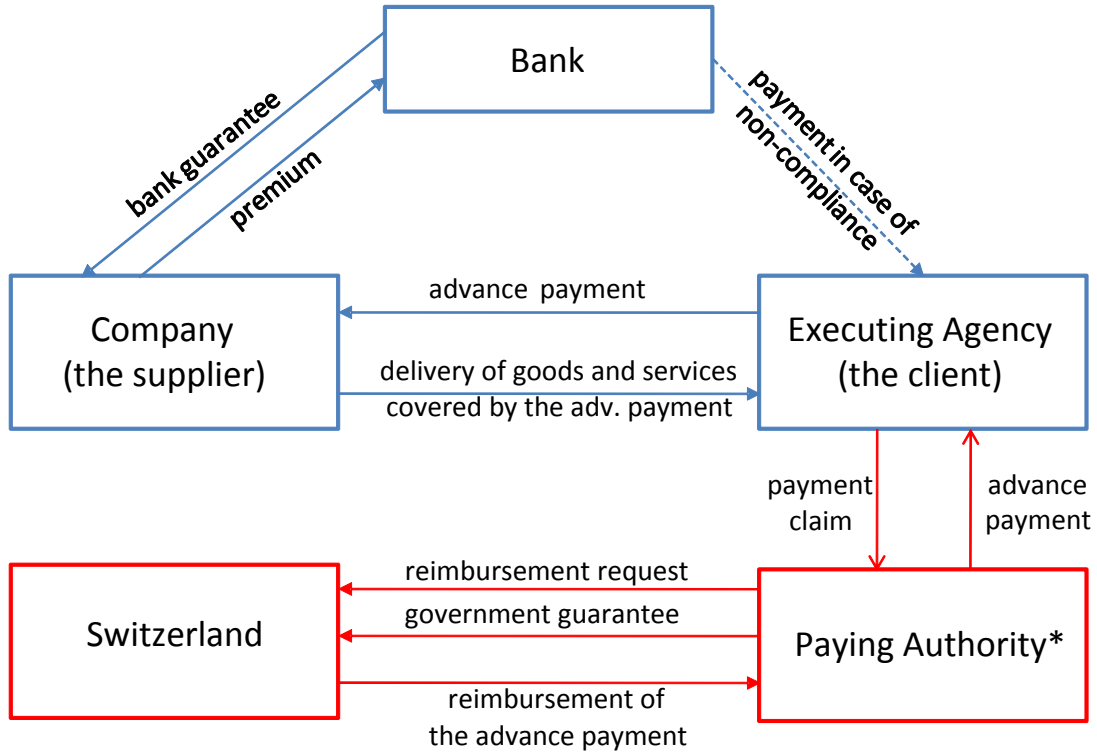
According to the chart above, it is for the Executing Agency to carry the financial burden of the advance payment. Hence, the Executing Agency has to come up with a considerable amount of upfront financing from its own budget. There is a considerable risk that the implementation of some Projects is jeopardized due to the limited liquidity of Executing Agencies.

To mitigate this risk, partner countries should consider taking the burden of advance payments off the Executing Agencies' shoulders, as it is the case for any other payment in the context of the Contribution Programmes. In this case, an Executing Agency submits the payment claim over the amount of the advance payment immediately to the Paying Authority which disburses the corresponding amount to the Executing Agency. The Paying Authority carries the financial burden of the advance payment and retains the corresponding reimbursement request to Switzerland up to the point where the supplier has duly delivered his corresponding contractual obligations.

In particular cases, advance payments can be treated as any other payment in the respective Contribution Programmes, with Switzerland reimbursing the corresponding requests in the amount of the advance payment. However, the following conditions apply:

- the advance payment is covered by a bank guarantee, protecting the Executing Agency against the risks mentioned above; and
- the Paying Authority* (in its role as Switzerland's partner institution for the financial handling of the Swiss Contribution) guarantees for the amount at stake.

The detailed terms and conditions (including the level of the advance payment) will have to be agreed upon in the respective Project Agreements. The disbursement schedule will be adjusted on a case-by-case basis. Furthermore, a mutual understanding of the conditions has to be found, under which Switzerland can trigger the government guarantee provided by the Paying Authority*. Furthermore, a mechanism for the reimbursement of funds in case a guarantee is triggered has to be established. The following graph illustrates this mechanism.



The role of the Project Agreements

The Project Agreements are negotiated between the NCU and Switzerland (SECO or SDC). Any type of advance payment that may be agreed between these parties will have to be mentioned in the respective Project Agreement and must be reflected in the annexed tentative disbursement schedule of the Project.

*The guarantee to Switzerland has to be issued directly by the Paying Authority or if mutually agreed by another national institution qualified to issue a government guarantee.