



NEPAL

# PEFA

An Assessment of the  
Public Financial Management  
Performance Measurement Framework  
**(As of FY 2005/06)**







**NEPAL**

# P E F A

Public Expenditure and Financial Accountability

## An Assessment of the Public Financial Management Performance Measurement Framework (As of FY2005/06)

**February 2008**

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## ABBREVIATIONS

ACU	Aid Coordination Unit
AER	Aid Effectiveness Review
AGA	Autonomous Government Agencies
CFAA	Country Financial Accountability Assessment
CFO	Chief Financial Officer
CIAA	Commission for the Investigation of Abuse of Authority
COFOG	Classification of Functions of Government
CPAR	Country Procurement Assessment Review
CTS	Central Treasury System
DAP	Development Action Plan
DDC	District Development Committee
DDF	District Development Fund
DOD	Disbursement of Outstanding Debt
DRI	Department of Revenue Investigation
DSA	Debt Sustainability Analysis
DTCO	District Treasury Controller Office
EBF	Extra Budgetary Fund
FAR	Financial Administration Regulations
FCGO	Financial Comptroller General Office
FMIS	Financial Management Information System
FPR	Financial Procedure Regulations
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GON	Government of Nepal
IAS	International Accounting Standards
ICAN	Institute of Chartered Accountants of Nepal
ICB	International Competitive Bidding
IDF	Institutional Development Fund
IGFR	Intergovernmental Fiscal Relations
IES	International Education Standards
IFAC	International Federation of Accountants
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standard (of IFAC)
IPSASB	International Public Sector Accounting Standard Board
IRD	Inland Revenue Department
IMF	International Monetary Fund
ISA	International Standards on Auditing
LSGA	Local Self Governance Act
MDA	Ministries, Departments and Agencies
MDG	Millennium Development Goal
MOF	Ministry of Finance
MOGA	Ministry of General Administration
MOLD	Ministry of Local Development
MTEF	Medium-Term Expenditure Framework
NAS	Nepal Accounting Standards
NASC	Nepal Administrative Staff College
NCB	National Competitive Bidding
NDS	National Development Strategy
NLSS	National Living Standard Survey
NPA	Non Performing Assets
NPPR	Nepal Portfolio Performance Review
NRB	National Rastra Bank
NVC	National Vigilance Center
OAG	Office of the Auditor General
ODA	Official Development Assistance
OECD-DAC	Organization for Economic Cooperation and Development – Development Assistance Committee
PAC	Public Accounts Committee
PAN	Permanent Account Number

PAR	Public Administration Reform
PE	Public Enterprises
PEFA	Public Expenditure and Financial Accountability
PEMS	Public Expenditure Management System
PETS	Public Expenditure Tracking Survey
PFM	Public Financial Management
PMAS	Project Management Administration System
PPMO	Public Procurement Monitoring Office
PRSP	Poverty Reduction Strategy Plan
SAI	Supreme Audit Institution
SOE	State-owned Enterprise
SN	Sub-national
SWAp	Sector-wide Approach
TIN	Taxpayer Identification Number
TXR	Tax Revenue
UNCITRAL	United Nations Commission for International Trade and Law
WTO	World Trade Organization



**Government of Nepal**  
**MINISTRY OF FINANCE**

February 15, 2008

**Dr. Ram Sharan Mahat**  
**Finance Minister**

**MESSAGE**

Improving governance and accountability underpins the agenda of the Government of Nepal (GON) for building a New Nepal that is prosperous, peaceful and just. Improved governance and accountability are vital for establishing and sustaining peace in Nepal. The GON is committed to enhancing governance and accountability, as articulated in the Three-Year Interim Plan (2007-10). A number of governance reform programs are already underway. These include improvements in budgeting and the implementation of the Medium Term Expenditure Framework (MTEF); improving the financial management information system and reporting; procurement reforms, including the enactment and implementation of the Procurement Act (2007); identifying gaps in public sector accounting and auditing and agreeing on actions to move towards international standards. It is a pleasure to state that the World Bank, the Asian Development Bank and the Department for International Development (DFID) of the United Kingdom have continuously been supporting Nepal governance reforms efforts.

The Public Expenditure and Financial Accountability (PEFA) guidelines provide benchmarks for assessing public financial management and are steps towards harmonizing aid as envisaged by the Paris Declaration for Aid Effectiveness. After the Country Financial Accountability Assessment (CFAA) in 2002 (updated in 2005), this effort to establish PFM benchmarks is another milestone towards improving overall governance. The GON acknowledges the technical and financial support provided by the World Bank in this endeavor. I would also like to commend the efforts of the Finance Secretaries, the Financial Comptroller General, the Auditor General, the Coordinator of the Working Committee and all government officials who participated in this exercise.

Improvements begin with the realization of the shortcomings and seeking solutions to address them. Though the PEFA results indicate a high-risk environment in Nepal, I see this effort as an opportunity to start improving the overall governance framework. The Development Action Plan (DAP) that has resulted from the stakeholders' consultation would guide GON in steering the reforms ahead. The benchmarks would also serve as a basis for measuring progress.

Implementing the DAP remains a major challenge given the country's delicate transition. But there is however no excuse for not trying. Therefore, GON will do everything in implementing the recommendations because therein lies Nepal's opportunities for fulfilling the growing aspirations of the citizens. Nepal will take a "platform approach" in implementing the reforms as well as overcoming the challenges through a series of measured steps to produce measurable results. It must also be said that GON efforts to improve PFM could succeed only with corresponding support from our development partners. I, therefore, request all the stakeholders and well-wishers to join hands in this crucial effort to push the governance reforms forward.

Ram Sharan Mahat





Government of Nepal  
**MINISTRY OF FINANCE**

Vidyadhar Mallik  
Secretary

February 15, 2008

### ACKNOWLEDGEMENT

The Public Financial Management (PFM) review was initiated by the Government and the World Bank in August 2005. The Public Expenditure and Financial Accountability assessment is based on the Public Expenditure and Financial Accountability (PEFA) framework. The assessment covers 31 indicators—which include three donor-related indicators that were assessed and benchmarked covering six core dimensions of an open and orderly PFM system. This is the first time that Nepal has assessed performance against the benchmarks. The Asian Development Bank (ADB), the Department of International Development (DFID), the Danish Development Agency (Danida), the International Monetary Fund (IMF), the Norwegian Embassy, the United Nations Development Program (UNDP) and the World Bank provided valuable inputs in the process.

The Joint Financial Comptroller General Deba Raj Pathak led the PEFA assessment. He was supported by a team of over 50 individuals representing the Ministry of Finance (MOF), the National Planning Commission (NPC), the Office of the Auditor General (OAG), the Financial Comptroller General Office (FCGO), the Ministry of Local Development (MOLD) and representatives from other line ministries/departments—education, health and works and transport, water resources and women, children and social welfare. I thank the entire team for their contribution to the process. I would also like to thank the former Financial Comptroller General Sushil Prasad Sharma Dhungel during whose tenure the review began taking shape. Likewise, I thank the Revenue Secretary Rameshwore Khanal for his guidance and support to the PEFA process. I also thank the Acting Financial Comptroller General Deep Basnyat for taking this initiative forward and concluding the assessment through a stakeholder workshop for reaching a consensus on the Development Action Plan (DAP) for PFM improvement. I also acknowledge and thank senior officials at various line ministries, departments, FCGO and the OAG who provided feedback on numerous drafts of the report.

Improving public financial management is a priority of GON for improving overall governance, optimizing outputs from public resources and for ensuring inclusive, broad-based development. GON commits to gradually improve the baseline indicators of this PEFA review in all six core PFM dimensions. I hope all development partners will assist GON in improving the PFM system in an integrated manner, by pooling resources and by implementing the actions identified in the Development Action Plan.

Finally, I thank the World Bank for its technical and financial support for carrying out the assessment. In particular, I would like to thank Bigyan Pradhan, Senior Financial Management and Operations Specialist and Roshan Darshan Bajracharya, Senior Economist for their guidance and support at all stages of the assessment.

Vidyadhar Mallik





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## PREFACE

The Public Expenditure and Financial Accountability Assessment (PEFA) provides the Government a basis for objectively assessing the country's Public Financial Management (PFM) systems. The assessment and establishment of PFM benchmarks, based on PEFA guidelines, is being published as the country moves towards establishing a New Nepal. This exercise enables a better understanding of the overall fiduciary environment and the opportunities for strengthening the overall PFM architecture.

The assessment led by GON was processed through a steering committee chaired by the Financial Controller General Office (FCGO), with representatives from the Ministry of Finance (MOF), the Office of the Auditor General (OAG) and various line ministries/departments. A nine-member core group was formed to lead sub-committees on eight major groups of PEFA indicators. Over 50 senior officers with expertise in each theme, representing various line agencies, were engaged in the consultations. The World Bank provided technical and financial support for the assessment. Other development partners such as, ADB, DFID, DANIDA, NORWAY, IMF and UNDP commented on the draft assessment. Extensive consultations were held with various stakeholders and their inputs were appropriately incorporated. The World Bank fielded special missions to review progress and provide inputs in the process. Progress was communicated to the development partners, and monitored through the Action Plan for Nepal Portfolio Performance Review (NPPR).

The assessment has established a PFM benchmark for Nepal based on PEFA guidelines measured against 28 indicators related to PFM and three donor-specific indicators. Each indicator is scored on a scale of A to D using M1 or M2 methodology in the guidelines. The findings suggest "high" fiduciary risk in Nepal and also indicate the opportunities for improving the indicators through Development Action Plan. The plan needs to be implemented through a platform approach for gradually mitigating the fiduciary risk. A focused, detailed, PFM review has been carried out at the local level, which is reported separately.

This report is the outcome of the entire team but some members need special mention. They are Prakash Man Shrestha (Inland Revenue Department), Madhu Marasini (Ministry of Finance), Shyam Dahal (Department of Customs), Nirmal Hari Adhikari (MOF), Ram Sharan Pudasaini (Large Tax Office), Dhurba Dahal (Ministry of Local Development), Babu Ram Gautam (Office of the Auditor General), Diwakar Rimal (FCGO), Durgesh Pradhan (MOF), Shiva Prasad Pandit, member-secretary of the PEFA working committee (FCGO), and all support staffs. Former Financial Comptroller General Sushil Prasad Sharma Dhungel and the Acting Financial Comptroller General Deep Basnyat deserve special appreciation for their continuous support and encouragement for the PEFA assessment. I am grateful to the two finance secretaries whose support made this report possible. Finally, I am thankful to Bigyan Pradhan and Roshan Darshan Bajracharya of the World Bank who supported and guided the entire PEFA process.

The assessment covers the period as of FY2005/06 ending on July 15, 2006.

GON commits to improve the PFM indicators and to gradually reduce the fiduciary risk. Nepal needs continued technical and financial support from development partners for pursuing this governance agenda with a high priority.

Daba Raj Pathak  
Co-ordinator  
PEFA Working Committee

15.02.08



## CONTENTS

	<u>Page No.</u>
<b>EXECUTIVE SUMMARY .....</b>	<b>vii – ix</b>
A. PFM Performance .....	vii
B. Assessment of the Impact of PFM Performance .....	viii
<b>I. INTRODUCTION .....</b>	<b>1 - 4</b>
Background .....	1
PFM Performance Measurement .....	2
PFM Framework .....	2
 <b>PART A: PUBLIC FINANCIAL MANAGEMENT SYSTEM</b>	
<b>II. OVERALL PERFORMANCE OF PUBLIC FINANCIAL MANAGEMENT SYSTEM .....</b>	<b>5 - 49</b>
A. Credibility of the Budget.....	5
B. Comprehensiveness and Transparency .....	10
C. Budget Cycle.....	18
D. Donor Practices .....	46
<b>III. SUSTAINING AND STRENGTHENING PFM PERFORMANCE: A ROADMAP .....</b>	<b>50 -87</b>
Annex 1 - Status of Budget and Expenditures from FY2003/04 - FY2005/06 .....	54-57
Annex 2 - Economic and Administrative Classifications .....	58-59
Annex 3 - Budget Preparation, Responsible Institutions and Timeline .....	60
Annex 4 - Development Action Plan For Strengthening Public Financial Management (PFM) Performance Short- And Medium-Term Action Plan.....	61-87
 <b>PART B: PUBLIC PROCUREMENT MANAGEMENT SYSTEM</b>	
<b>IV. PUBLIC PROCUREMENT AND DEVELOPMENT EFFECTIVENESS.....</b>	<b>88-100</b>
Pillar I. Legislative and Regulatory Framework .....	92
Pillar II. Institutional Framework and Management Capacity .....	94
Pillar III. Procurement Operations and Market Practices .....	96
Pillar IV. Integrity of the Public Procurement System.....	98
<b>V. CONCLUSIONS AND RECOMMENDED ACTIONS FOR PUBLIC PROCUREMENT REFORM.....</b>	<b>101-102</b>
 <b>PART C: NAMES OF INDIVIDUALS INVOLVED IN THE PEFA PROCESS..</b> 103-107	



# THE PERFORMANCE OF NEPAL'S PUBLIC FINANCIAL MANAGEMENT SYSTEM

## Executive Summary

### A. PFM Performance

The assessment of Nepal's performance in Public Finance Management (PFM) suggests the existence of a system that is well-designed but unevenly implemented. The budget has become a credible policy tool, clearly linked to policies in some sectors, with solid control of aggregate outturns and a reasonable control framework at the transaction level (notably for payroll). However, there are many gaps in the control framework as well as significant implementation constraints, and large fiscal activities remain outside the scope of the central budget. Several weaknesses originate in the weak demand (from both Government and external stakeholders) for better budget information (financial and physical) and management.

**Credibility of the budget.** The budget is credible at the aggregate level. The main exception is for capital expenditure, which has tended to remain below the budgeted levels. This shortfall has resulted from: (i) PFM-related implementation weaknesses (e.g. lack of or delays in preparing annual work plans along with procurement plans); (ii) non-PFM implementation constraints (e.g. conflict and security issues, technical capacity); and (iii) uncertainties related to donor funds. In addition, the credibility is undermined by significant deviations in terms of expenditure composition (in part due to shortfalls in capital spending) and large fiscal activities outside the budget.

**Comprehensiveness and transparency.** The budget is based on a good classification system (in need of minor improvements) and is published. In recent years GON has made good efforts to improve the budget coverage with reports on a “consolidated fund” and monitoring of some fiscal risks (notably, the situation of public enterprises). However, a significant—and possibly growing—gap has resulted from fiscal activities of (i) many development funds and boards, and (ii) local governments.

**Policy-based budgeting.** Significant progress has been made toward a sound policy-based budget with the adoption of the Medium Term Expenditure Framework (MTEF) and the creation of “business plans” for several sectors. Gaps include: (i) lack of engagement of the political leadership on the MTEF and budget preparation; (ii) inadequate engagement or understanding of the MTEF among middle and lower-level government officials; (iii) uneven linkages between annual budgets and MTEFs; and (iv) incomplete sectoral “business plans” (in need of stronger monitoring of outputs).

**Predictability and control in budget execution.** Predictability in budget execution has improved significantly, with guaranteed cash releases for high priority (“P1”) projects (provided implementation is satisfactory). Payroll controls are also well developed. The Public Procurement Act (2007) is aligned with best international practice but its implementation remains to be tested. A basic control framework for non-salary expenditures, which includes physical verification, is in place but is unevenly implemented. There is no commitment control. Internal audit is not effective and does not comply with international standards. It focuses narrowly on pre-audit of transactions (with no system reviews). The system is even more unreliable at the district level where there are capacity constraints. Service delivery units receive information about budget releases but there is little monitoring of actual expenditures and outputs at this level. Much progress remains to be made toward better accounting of revenues and services to taxpayers.

**Accounting, recording, and reporting.** Current cash-based accounting practices are generally well-established and accounts are frequently reconciled (with the exception of revenue accounts). However, incomplete computerization has weakened the timeliness and quality of accounting.

Annual reporting and financial statements are timely and of acceptable quality (although there are some gaps in content). Within-year reporting is weak and is not publicized. There is no national Public Sector Accounting Standard. The audited consolidated financial statements and annual revenues and expenditure statements do not include accounting policies and explanatory notes as required by International Public Sector Accounting Standard (IPSAS). However, the consolidated financial statements issued by FCGO for government use include basic accounting principles and assumptions. The financial statements prepared by the line ministries, FCGO and Office of the Auditor General (OAG) do not reconcile since the accounting system does not allow recording non-cash transactions (direct payments and commodity grant or aid or turnkey projects) due to which FCGO faces difficulties in providing true and fair picture of such transactions.

**External scrutiny and audit.** Annual financial statements are audited by an independent Auditor General in a timely manner and the report is discussed by a Public Accounts Committee (PAC), although this was weak in the recent past owing to the political situation. There is, however, little evidence of follow-up for clearing “irregularities” identified by the Auditor General. The annual audit reports, follow-up activities and external scrutiny focus more on “irregularities” as opposed to correcting systemic issues. External scrutiny was also weakened by (i) long political uncertainty, (ii) a lack of public access to information (including accounts of local governments; contracts), and (iii) weak process to engage the legislature in discussing the MTEF and in scrutinizing the budget.

**Donor practices.** Despite progress in recent years (toward general and sector-specific budget-support), much remains to be done to meet the principles of Nepal’s 2002 Foreign Aid Policy (and the Paris Declaration). In particular, the quality of financial information provided by donors is weak and the proportion of aid that uses national procedures is much below 50%.

## B. Assessment of the Impact of PFM Performance<sup>1</sup>

The performance in terms of **fiscal discipline** is generally positive but remains threatened by four main weaknesses: (i) lack of monitoring of fiscal risks (including those related to donor funding) is creating significant uncertainties; (ii) poor capital budget preparation and implementation weakens GON’s capacity to make the best use of existing fiscal space; (iii) weak sector strategies prevent GON from managing the MTEF; and (iv) weak reconciliation of revenue accounts reduces available resources.

Similarly, the progress in **strategic allocation of resources**—through the MTEF, business plans, prioritization of projects for cash management—has somewhat realigned resources, but falls short of its promises due to (i) weak capital budget preparation and implementation; (ii) insufficient reporting systems (in-year financial data and monitoring of outputs); and (iii) large amounts of spending outside mainstream reporting systems (dedicated funds and boards; donor-funded projects, etc.). This is compounded by insufficient engagement of the political leadership and external scrutiny on the strategic allocation across sectors.

The **efficiency in delivering services** has improved, notably through more predictable cash releases and some devolution of resources. However, it is hampered by several factors, including lack of procurement plans and non-observance of competitive tendering; focus of internal audit on transactions and external audit only on “irregularities” as opposed to systemic improvements; and major gaps in monitoring systems. These factors result into an ineffective bunching of expenditures toward the end of the fiscal year.

Finally, there has been progress towards **transparent and accountable management of public finances**. However critical gaps—coverage of fiscal reports, within-year reporting, access to information on taxpayer liabilities and procurement activities, quality of external audit report, and engagement of the legislature—remain.

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<sup>1</sup> The assessment period ends in FY2005/06

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## PFM High-Level Performance Indicator Set

<b>A. PFM OUTCOMES: Credibility of the budget</b>		<b>Result</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
PI-1	Aggregate expenditure outturn compared to original approved budget	B				
PI-2	Composition of expenditure outturn compared to original approved budget	C				
PI-3	Aggregate revenue outturn compared to original approved budget	A				
PI-4	Stock and monitoring of expenditure payment arrears	D+				
<b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>						
PI-5	Classification of the budget	C				
PI-6	Comprehensiveness of information included in budget documentation	B				
PI-7	Extent of unreported government operations	C				
PI-8	Transparency of inter-governmental fiscal relations	C				
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D+				
PI-10	Public access to key fiscal information	B				
<b>C. BUDGET CYCLE</b>						
<b>C(i) Policy-based Budgeting</b>						
PI-11	Orderliness and participation in the annual budget process	C+				
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+				
<b>C(ii) Predictability and Control in Budget Execution</b>						
PI-13	Transparency of taxpayer obligations and liabilities	C+				
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C				
PI-15	Effectiveness in collection of tax payments	D+				
PI-16	Predictability in the availability of funds for commitment of expenditures	C+				
PI-17	Recording and management of cash balances, debt and guarantees	C+				
PI-18	Effectiveness of payroll controls	C+				
PI-19	Competition, value for money and controls in procurement	C				
PI-20	Effectiveness of internal controls for non-salary expenditure	C				
PI-21	Effectiveness of internal audit	D+				
<b>C(iii) Accounting, Recording and Reporting</b>						
PI-22	Timeliness and regularity of accounts reconciliation	C+				
PI-23	Availability of information on resources received by service delivery units	C				
PI-24	Quality and timeliness of in-year budget reports	C+				
PI-25	Quality and timeliness of annual financial statements	C+				
<b>C(iv) External Scrutiny and Audit</b>						
PI-26	Scope, nature and follow-up of external audit	D+				
PI-27	Legislative scrutiny of the annual budget law	D+				
PI-28	Legislative scrutiny of external audit reports	D+				
<b>D. DONOR PRACTICES</b>						
D-1	Predictability of Direct Budget Support	D				
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D				
D-3	Proportion of aid that is managed by use of national procedures	D				



## I. INTRODUCTION

This Public Financial Management (PFM) Performance Measurement Framework Report is organized in five sections. The country background, objectives and scope of this review and the overview of the PFM framework of the Government, are provided in the introduction. The second section—Overall Performance of PFM system—provides the analysis and ratings for 28 PFM indicators and three donor-activity indicators. The third section outlines a roadmap for improving PFM performance with a detailed Annex (Annex-4) providing a summary of the assessment and concrete actions required for change. The fourth section discusses the role of public procurement in development effectiveness. The final section discusses the challenges and opportunities in procurement reform, and suggested actions for procurement reform.

## BACKGROUND

**Political Context.** The political change of April 2006 has opened a new chapter in the history of Nepal. The signing of a comprehensive peace agreement between the Government of Nepal (GON) and the Communist Party of Nepal-Maoists (CPN-M) in November 2006 lays out a roadmap for establishing a new governance structure and lasting peace. Nepali citizens feel that they can now steer their country on a firm path towards a “New Nepal”, which is peaceful, inclusive, just and prosperous. But the road ahead is not without risks. In the short-run, the political situation could remain fluid and potentially unstable until the Constituent Assembly elections are held and all sides accept the results. Despite the political uncertainty, the Government is committed to implement reforms for strengthening the PFM framework. The initiative to carry out a self-assessment of the PFM benchmark is a good example for self- and critical diagnosis for finding ways to move forward for improving the overall framework. The enactment of the Public Procurement Act is another example of GON’s commitment to move towards harmonization of procurement procedures with international standards. Similarly, participating in the Gap Analysis of Public Sector Accounting and Auditing Standards with the World Bank is another example of the desire to identify the gaps in accounting and auditing standards vis-à-vis international standards. The agenda for PFM reform is challenging but the Government is committed to take the necessary steps needed for improvement.

**Economic Context.** Nepal remains a poor country (GDP per capita: US\$290) with significant gaps in social outcomes and large disparities across the population. The medium-term macroeconomic outlook rests heavily on the prospects for sustained peace and political stability. Lasting improvement in the security situation, a return to normalcy on the political front and concurrent acceleration of key economic reforms ought to lead to growth rates of 5% or more. Growth would be driven by marked rebounds in the manufacturing and services sectors, and would be enhanced by contributions from public sector investments and increased tourism earnings. Long-run growth prospects would depend on improvements in the stock of human capital, improvements in governance and a deeper financial sector. However, lower growth rates—2-3%—could result from resumption of conflict. The fiscal framework—with a deficit (before grants) of around 3.5% of GDP—is an indicative one, given the possible shifts in public expenditures following a likely peace dividend. The cessation of the armed conflict will be instrumental in containing security spending pressures, and in bolstering the revenue effort and the public sector’s ability to scale up capital investments. At the same time, election-related and immediate post-conflict expenses will need to be factored in. The current account balance is likely to remain positive as remittances are projected to grow faster than the deficit in the trade account. On the fiscal front, the deficit (after grants) declined from 4.0% of GDP in FY2001/02 to 1.7% in FY2005/06. The economic and social profile of Nepal changed significantly since the political changes of 1990 and the economic reforms that followed. Income per capita grew at 2.6% per annum during the 8<sup>th</sup> Plan (1992-97) and growth was above 1% during the 9<sup>th</sup> Plan (1997-2002).

## **PFM PERFORMANCE MEASUREMENT**

**Objectives and Scope.** This assessment follows the Public Financial Management Performance Measurement Framework prepared by Public Expenditure Working Group (World Bank, IMF and Joint Donor Public Expenditure and Financial Accountability Unit, available at <http://www.pefa.org/Documents.htm>). The assessment measures the PFM performance benchmarks in Nepal as of FY2005/06. The methodology examines the soundness of the PFM framework by rating 28+3 indicators (three are related to donor practices) using specific criteria provided by the guidelines. The assessment covers fiscal and debt management; budget formulation and execution; internal controls, procurement, accounting and reporting; auditing, transparency and external scrutiny. The methodological document referred above provides specific criteria for rating for each indicator.

This assessment focuses on the central government. It does not cover the local-self governments (except for Indicator 8) or arrangements for state-owned enterprises (SOEs) (with the exception of Indicator 9). This assessment also excludes donor funding implemented outside the government's financial management framework—the “off-budget” expenditures

## **PFM FRAMEWORK**

**The assessment of Nepal’s performance in PFM suggests a system that it is generally well designed but unevenly implemented.** The budget has become a policy tool that is largely credible. It is clearly linked to policies in some sectors with solid control of aggregates and has a reasonable control framework at the transaction level (notably for payroll). However, there are gaps in the control framework and implementation, and large fiscal activities remain outside the scope of the Government budget. These weaknesses reflect the weak demand (from both Government and external stakeholders) for better budget information (financial and physical) and management.

**Credibility of the budget.** The budget is credible at the aggregate level for revenues and recurrent expenditures. However, the capital budget falls chronically short of the estimate. In addition, credibility is undermined by significant deviations in terms of expenditure composition (partly due to shortfalls in capital spending) and large fiscal activities outside the budget (see previous section).

**Comprehensiveness and transparency.** The budget is based on a solid classification system (in need of minor improvements) and is published. GON has made good efforts to improve the coverage of the budget with reports on a “consolidated fund” and monitoring of some fiscal risks (notably the situation of public enterprises). However a significant—and possibly growing—gap results from fiscal activities of (i) many development funds and boards, and (ii) local-level governments (covered by annual audit reports but not by the budget itself or any other public report). Additionally, transparency could be improved especially for systematizing reporting on past achievements and to make the reports more analytical.

**Policy-based budgeting.** Significant progress has been made toward a sound policy-based budget system after Nepal began using the MTEF to cover the entire budget and the creation of “business plans” for several sectors. Gaps include: (i) lack of engagement of the political leadership on the MTEF and budget preparation; (ii) inadequate engagement or understanding of the MTEF by middle and lower-level government employees; (iii) insufficient focus on past achievements and monitoring of outputs; and (iv) residual focus on fragmented projects as opposed to programs structured around sector strategies (or “business plans”).

**Predictability and control in budget execution.** Predictability in budget execution has improved significantly through guaranteed cash releases to high priority (“P1”) projects (provided that implementation is satisfactory). Payroll controls are also well developed. Procurement has positive features, with some gaps (complaint mechanism and monitoring system, for example) that are to be

addressed by the new law<sup>2</sup>. However, the use of less-competitive procurement methods is often not adequately justified. A basic control framework for non-salary expenditures, which includes physical verification, is in place but is implemented unevenly. There is no commitment control. Internal audit focuses limitedly on pre-audit of transactions (with no system reviews). Service delivery units receive information about budget releases but there is little monitoring at the level of actual expenditures and outputs. On the revenue side, progress remains to be made toward better accounting of revenues and services to taxpayers.

*Accounting, recording and reporting.* Existing cash-based accounting practices are generally well-established and accounts are frequently reconciled with the exception of revenue accounts. However, incomplete computerization has weakened the timeliness and quality of accounting. In addition, there are gaps between accounting policies and international standards—Nepal does not have an official public sector accounting standard. Annual reporting and financial statements are timely and of acceptable quality but there are some gaps in the content. The Gap Analysis for Public Sector Accounting and Auditing carried out by the World Bank in collaboration with GON (Nepal Public Sector Accounting and Auditing: May 2007) has examined the shortfalls and recommended improvements. Within-year reporting is weak and is not made public.

*External scrutiny and audit.* Annual financial statements are audited by an independent Auditor General in a timely manner and reports are discussed by a parliamentary body, the Public Accounts Committee (PAC). (PAC reviews were weaker after May 2002 owing to the political situation). However, annual audit reports and external scrutiny focus more on “irregularities” as opposed to identifying and correcting systemic issues and there is little evidence of follow-up for clearing irregularities identified by the Auditor General. External scrutiny was also weakened by (i) long political uncertainty, (ii) lack of public access to information (including accounts of local governments and contracts), and (iii) weak process to engage the legislature in discussing the MTEF and in scrutinizing the budget.

*Donor practices.* Despite progress toward general and sector-specific budget-support, much remains to be done for meeting the principles of Nepal’s Foreign Aid Policy 2002 (and the Paris Declaration). The quality of financial information provided by donors is weak and the proportion of aid using national procedures is much below 50%.

The performance in fiscal discipline is generally positive but remains threatened by four main weaknesses: (i) lack of monitoring of fiscal risks (including that related to donor funding) that creates significant uncertainties; (ii) poor capital budget preparation and implementation that weakens the Government’s capacity to make the best use of existing fiscal space; (iii) weak sector strategies that prevents Government from managing medium-term fiscal space; and (iv) weak reconciliation of revenue accounts that reduces available resources.

The progress in strategic allocation of resources—through the MTEF, business plans, prioritization of projects for cash management—has somewhat realigned resources but falls short of its promise due to (i) weak capital budget preparation and implementation; (ii) insufficient reporting systems (in-year financial data and monitoring of outputs); and (iii) large spending outside mainstream reporting systems (dedicated funds and boards, donor-funded projects, etc.). This is compounded by insufficient engagement at the political level and low external scrutiny on the strategic allocation across sectors.

The efficiency of delivering services has improved, notably through more predictable cash releases and some devolution of resources. However, it is hampered by several factors, including lack of procurement plans and non-observance of competitive tendering; focus of internal audit on transactions and external audit only on “irregularities” as opposed to systemic improvements; and major gaps in the monitoring systems. These factors result in ineffective bunching of expenditures toward the end of the fiscal year.

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<sup>2</sup> The Public Procurement Act was enacted in January 2007.

Finally, Nepal has progressed towards transparent and accountable management of public finances. However critical gaps—coverage of fiscal reports, in-year reporting, access to information on taxpayer liabilities and procurement activities, quality of external audit report and engagement of the legislature—remain.

## **PART A:**

# **PUBLIC FINANCIAL MANAGEMENT SYSTEM**



## **II. OVERALL PERFORMANCE OF PUBLIC FINANCIAL MANAGEMENT SYSTEM**

### **A. CREDIBILITY OF THE BUDGET**

#### ***Indicator 1 (PI-1): Aggregate expenditure outturns compared to original approved budget***

*The ability to implement the budgeted expenditure is an important factor in supporting the government's ability to deliver public services for the year as expressed in policy statements, output commitments and work plans. The indicator reflects this by measuring the actual total expenditure compared to the originally budgeted total expenditure (as defined in government budget documentation and fiscal reports), but excludes two expenditure categories over which the government will have little control. Those categories are: (a) debt service payment, which, in principle, the Government cannot alter during the year, while they may change due to interest and exchange rate movements; and, (b) donor-funded project expenditure, the management and reporting of which are typically under control of donor agencies to a high degree.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges but also excluding externally financed project expenditure).

#### **Rating PI-1: B**

#### **Explanation of Score**

- (i) In no more than out of one of the last three years has the actual expenditure deviated by an amount equivalent to more than 10% of budgeted expenditure. (B)

#### **Justification for Score**

*Nepal has always been a fiscally responsible state and it has made strong progress toward the Poverty Reduction Strategy (PRS) outcomes (Fourth PRS progress report, January 2007). Nepal has managed competing claims on resources to avoid large fiscal deficits largely by sacrificing capital expenditure while lowering domestic borrowing—a cost to future growth potential—for maintaining fiscal discipline at the aggregate level. This has been achieved despite the weak economy, declining aid resources and increasing security and debt repayment expenditures.*

**Table 2.1: Selected Macroeconomic Indicators**

	FY2001/02 - FY2005/06				
	FY01/02	FY02/03	FY03/04	FY04/05	FY05/06
<b>Growth (percent change)</b>					
Real GDP at market prices	-0.6	3.4	3.7	2.7	1.9
CPI (period average)	2.9	4.7	4.0	4.5	8.0
<b>Government finances (percent of GDP)</b>					
Total revenue	11.5	12.3	12.2	12.9	12.2
Total expenditure	16.9	16.0	15.5	16.5	16.2
Current expenditure	11.5	11.4	11.2	11.6	11.4
Capital expenditure	5.4	4.6	4.3	4.9	4.8
Overall deficit (before grants)	5.4	3.7	3.3	3.5	3.9
Overall deficit (after grants)	4.0	1.6	1.0	0.8	1.7
Net domestic borrowing	2.9	0.9	0.6	0.2	1.4
Public debt	69.5	66.5	65.2	59.0	56.2
Broad money growth (end of period)	4.4	9.8	12.8	8.3	15.6
91-day T-bill (end of period; percent)	3.8	3.0	1.5	3.9	3.3
<b>Balance of payments (percent of GDP)</b>					
Current account balance (excluding grants)	1.9	0.3	0.9	-0.3	0.6
Trade balance	-12.6	-15.4	-15.6	-16.1	-19.1
External debt	53.4	52.6	51.2	45.8	43.0
Debt service	4.9	5.0	4.5	4.5	4.2
Gross official reserves (end of period) (months of imports of goods and services)	7.0	6.6	7.3	6.2	6.5

The ratio of actual expenditure to approved budget is as follows:

1. FY 2003/04 = 94.12%,
2. FY 2004/05 = 99.81%, and
3. FY 2005/06 = 94.44%.

The deviation in actual expenditure, excluding debt service payment and expenditure of donor-funded projects, from the budget of the year in question ranges from 6-13.5%. This deviation resulted from rapid increases in recurrent expenditure which surpassed revenue growth. Rise in security-related expenses—owing to the conflict—and salary increases are two major demand factors that contributed to the growth in expenditure. On the resource side, with domestic borrowing capped at a fixed percentage of budget, shortfalls in projected revenue—owing to insurgency-related slow down of the economy and frequent strikes—resulted in widening the gap between sources and uses of funds. The deviation of the actual from budgeted expenditure was more than 1% in fiscal year 2004/05 and more than 5% for the other two fiscal years (Annex 1).

***Indicator 2 (PI-2): Composition of expenditure outturns compared to original approved budget***

*The budget cannot remain to be a useful statement of policy intent where the composition of expenditure varies considerably from the original budget. Measurement against this indicator requires an empirical assessment of expenditure outturns against the original budget at a sub-aggregate level. As budgets are usually adopted and managed on an administrative (ministry/agency) basis, it is preferred for assessment. However, a functional basis is an acceptable alternative. At administrative level, variance shall be calculated for the main budgetary heads of ministries, independent departments and agencies, which are included in the approved budget. If functional classification is used, it should be based on the 10 main functions of Government Finance Statistics (GFS)/Classification of Functions of Government (COFOG).*

*Changes in overall level of expenditure (assessed in PI-1) will translate into changes in spending for administrative (and functional) budget lines. This indicator (PI-2) measures the extent to which reallocations between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. Making that assessment requires that the total variance in the expenditure composition is calculated and compared with the overall deviation in primary expenditure for each of the last three years.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years

**Rating PI-2: C.**

**Explanation of Score**

- (i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than the last three years. (C)

## **Justification for Score**

The Financial Administration Regulations (FAR) restricts the magnitude of authorized fund transfer or virement across sectors, intra sectors, budget lines and within budget lines or economic heads. Sectoral ceilings are strictly abided and, categorization of budget lines under priorities—P1<sup>3</sup>, P2, P3—prohibits virement from P1 to P3. To further limit the scope of virement—limitation across economic heads—Rule 39 (3) of FAR has capped the authority to the Secretary and Departmental Head to 25% of the allocated amount as virement ceiling on any particular line item and virement authority from one functional head to another rests with Ministry of Finance (MOF). Provisions in Financial Procedure Act authorize MOF to make virement from one surplus economic head to another but staying within the limit of appropriation bill. These provisions help to ensure that activities are not starved of funds on account of administrative discretionary powers. Transparency of virement is recorded with quantification of levels of fund transfers from each functional head and is reported in Financial Comptroller General Office's (FCGO) annual report or “Consolidated Financial Statement”.

Total variance in expenditure composition compared to overall deviation in primary expenditure is as follows: FY2003/04 = 6%, FY2004/05 = 13.5% and 2005/06 = 9.5%. Revenue surplus severely limits the degree of virement. If there is need for virement having strict transparent fund transfer rules and regulations limits discretionary reallocation of funds and that too, within economic heads from savings on recurrent economic heads only. For details, please see Annex 1.

**Table 2.2: Expenditure Variations**

Fiscal Year	Variance in excess of total deviation (in %)
2003/04	6
2004/05	13.5
2005/06	9.5

## **Indicator 3 (PI-3): Aggregate revenue outturn compared to the original approved budget**

*Accurate forecasting of domestic revenue is a critical factor in determining budget performance since budgeted expenditure allocations are based upon that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting.*

*External shocks may however occur, that could not have been forecast and do not reflect inadequacies in administration, they should be explained in the narrative. The calibration allows for a top score even if during one year in the last three the outturn is substantially different from the forecast e.g. as a result of a major external shock occurring during budget execution.*

### **Dimensions to be assessed (Scoring Method M1):**

- (i) Actual domestic revenue collection compared to domestic revenue estimates in the original approved budget.

### **Rating PI-3: A.**

### **Explanation of Score**

- (i) Actual domestic collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years. (A)

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<sup>3</sup> 75% of total budget.

## Justification for Score

The “Resource Committee”— made up of the Vice Chairman of National Planning Commission (NPC), Secretary of the Ministry of Finance and Governor of the Nepal Rastra Bank (central bank)—meets for finalizing the budget aggregates for expenditure, domestic revenue, domestic borrowing and aid levels for the coming fiscal year. Inputs from respective institutions, MTEF and outputs/reports of specific task forces commissioned during the year are weighed in towards finalization of the budget aggregates for the coming year.

The ratio of actual revenue to budget is as follows: FY2003/04 = 107% (66.60/62.22), FY2004/05 = 102.3% (71.92/70.32) and FY2005/06 = 88.4% (72.28/81.81). Domestic revenue is made up of 79% tax and 21% non-tax revenue. The base of revenue target is trade tax—29% of total tax revenue (FY 2005). During the observation period, the insurgency not only slowed down economic growth but also deteriorated the industrial climate and confidence resulting in weakened enforcement and tax compliance.

Actual domestic revenue collection was below 97% of budgeted estimate in one of three years reviewed. Although the collection for two years was above the original targets (FY2003/04 and FY2004/05), the collection in FY2005/06 was below original target (88%) affected largely by civil unrest—Jana Andolan II (People’s Movement II). Revenue collection recovered after stability was restored but it was not strong enough for meeting the budget target. Revenue collection for the first three quarters of FY2005/06 before the Jana Andolan II (mid July to mid April) recorded a shortfall of 17 percentage points. The collection made a strong comeback (mid April to mid July) resulting a shortfall of only 12% at the end of the fiscal year.

**Table 2.3: Status of Revenue Collection**

Fiscal Year	Annual Target	Actual Collection	Target vs. Achievement (%)
2002/03	57,150,170	56,229,791	98.39
2003/04	62,227,000	66,597,218	107.02
2004/05	70,320,000	71,921,914	102.28
2005/06	81,816,600	72,281,742	88.35

**Table 2.4: Revenue Sources and Collection in FY2005/06**

Revenue	Actual Collection	Percentage in Total
Indirect Tax Total	43,478,790	60.15
Direct Tax Total	13,947,473	19.3
Tax Revenue Total	57,426,263	79.45
Non tax with Principal	14,855,479	20.55
Total	72,281,742	100

## *Indicator 4 (PI-4): Stock and monitoring of expenditure payment arrears*

*Expenditure payment arrears are expenditure obligations that have been incurred by government for which payment to the employee, supplier, contractor or creditor is overdue, and constitutes a form of non-transparent financing. A high level of arrears can indicate a number of different problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and lack of information. Expenditure arrears assume that the outstanding payment is due under a specific legal obligation or contractual commitment, which the government has entered and may include due but unpaid claims for salaries, pensions, supplies, services, rents, interest on domestic and external debt. Delays or reduction in transfer of subsidies and grants to autonomous government agencies and other levels of government would not constitute arrears unless they are part of a legal obligation (specifying amount and timing of each payment) or contractual agreement. A provision for a transfer in the annual budget law or appropriations act would not in itself constitute a legal obligation. Unpaid amortization of loan principal is not considered an arrear for this indicator, since amortization is not expenditure, but a financing transaction.*

*Local regulations or widely accepted practices may specify when an unpaid claim becomes in arrears. If such a local practice is applied in measuring the stock of arrears then its content and basis should be described in the narrative. The default for the assessment, however, would be internationally accepted business practices according to which a claim will be considered in arrears if payment has not been made within 30 days from Government's receipt of supplier's invoice/claim (for supplies, services or works delivered), whereas the failure to make staff payroll payment or meet a deadline for payment of interest on debt immediately results in the payment being in arrears.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.
- (ii) Availability of data for monitoring the stock of expenditure payment arrears.

**Rating PI-4: D+**

**Explanation of Score**

- (i) The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years (C)
- (ii) There is no reliable data on the stock of arrears from the last two years. (D)

**Justification for Score**

**Stock of arrears constitutes 2-10% of total expenditure; and there is no evidence of it being reduced significantly in the last two years.** Cash accounting is the accounting system of GON. It is a flow accounting system and therefore, is weak in tracking and recording of stock. Auditor General Form No. 18, under the FAR, needs to be recorded at the end of the fiscal year and certified by Office-in-Charge and Chief of the Financial Administration Section to capture the reporting of arrears (stock). The system is in place for reporting and recording arrears which is, at best, incomplete and not seriously followed. The FCGO's "Consolidated Financial Statement" shows year-end total arrears as percentage of total expenditure: 0.52%; 0.26% and 0.62% in FY 04, FY 05 and FY 06 respectively. However, in view of lapses in rules and the general practice of recording arrears—one of which is presenting and pushing running bills of activities of this fiscal into the next and there is no evidence of reforms to improve the practice—the present stock of monitoring of arrears is, at best, partial and incomplete. It is estimated to be more than 2% but does not exceed 10% of total expenditure.

**There is no reliable data on the stock of arrears.** The system of recording arrears is weak. Much of this weakness stems from (a) weak enforcement (not everyone fills in Form Number 18 at the end of fiscal year); (b) weak coverage (many committees, boards and public enterprises do report arrears but not annually); (c) not included in reporting, special decisions of Government (related to emergencies, natural calamities and others); and, (d) weak accounting system for consolidating arrears that are reported. With poor reporting and recording system—resulting from the flow accounting system, poor coverage and compliance—data for monitoring arrears in stock and expenditure payment of arrears, is at best, partial.

## **B. COMPREHENSIVENESS AND TRANSPARENCY**

### ***Indicator 5 (PI-5): Classification of the budget***

*A robust classification system allows the tracking of spending on the following dimensions: administrative, economic, functional and program. Where standard international classification practices are applied, governments can report expenditure in GFS format and track poverty-reducing and other selected group of expenditure. The budget will be presented in a format that reflects the most important classifications (usually administrative combined with economic, functional and/or programmatic) and the classification will be embedded in the charts of accounts to ensure that all transactions can be reported in accordance with any of the classification used.*

*In countries where a poverty reduction strategy is a core element in the government's overall policy framework, the definition of poverty-reducing expenditure is normally linked directly to the classification of the budget.*

*The international standard for classification systems is the GFS, which provides the framework for economic and functional classification of transactions. Under the UN-supported COFOG, which is the functional classification applied in GFS, there are 10 main functions at the highest level and 69 functions at the second (sub-functional) level.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) The classification system used for formulation, execution and reporting of the central Government's budget.

#### **Rating PI-5: C**

#### **Explanation of Score**

- (i) The budget formulation and execution is based on administrative and economic classification using GFS Standards or a standard that can produce consistent documentation according to those standards. (C)

#### **Justification for Score**

The “Budget Classification” captures constitutional and functional details, economic heads and line item allocations under recurrent and capital classification, and sector-wise priorities. Similarly, budget formulation and monitoring of execution are based on administrative and economic classifications with more than 10 classifications of function of the Government (COFOG) under 44 line items. The move towards the full GFS system is still evolving as per the country’s need and capacity. Although not part of direct budget classification, GON records and monitors “pro-poor” expenditure through an indigenous pro-poor code system. The current classification and chart of accounts follows GFS coding formats and standards on the flow side but not the stock. Stock information, if so desired, as per GFS standards, can be tabulated accordingly. The focus of budget preparation is along economic and administrative classifications (See Annex-2 for details).

## **Indicator 6 (PI-6): Comprehensiveness of information included in budget documentation**

*Annual budget documentation (the annual budget and budget supporting documents) as submitted to the legislature for scrutiny and approval, should allow a complete picture of central Government's fiscal forecasts, budget proposals, and outturn of previous years. In addition to the detailed information on revenues and expenditures, and in order to be considered complete, the annual budget documentation should include information on the following elements:*

- (i) *Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.*
- (ii) *Fiscal deficit, defined according to GFS or other internationally recognized standard.*
- (iii) *Deficit financing describing anticipated composition.*
- (iv) *Debt stock, including details at least for the beginning of the current year.*
- (v) *Financial assets, including details at least for the beginning of the current year.*
- (vi) *Prior year's budget outturn, presented in the same format as the budget proposal.*
- (vii) *Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.*
- (viii) *Summarized budget data for both revenue and expenditure according to the main heads of the classification used (ref. PI-5), including data for the current and previous year.*
- (ix) *Explanation of budget implications of new policy initiatives, with estimates of budgetary impact of all major revenue policy changes and/or some changes to expenditure programs.*

### **Dimensions to be assessed (Scoring Method M1):**

- (i) Share of the above listed information in the budget documentation most recently issued by the central Government (in order to count in the assessment, the full specification of the information benchmark must be met).

### **Rating PI-6: B**

#### **Explanation of Score**

- (i) Recent budget documentation fulfils 5-6 of the 9 information benchmarks. (B)

#### **Justification for Score**

Together with the annual budget speech and other budget appropriation documents, which are available on-line the very same time budget is presented in parliament, only three out of the following nine PEFA benchmarks are incomplete:

- Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate. **Complete.** This information is provided in the budget speech.
- Fiscal deficit, defined according to GFS or other internationally recognized standard. **Complete.** This information is provided in the budget speech.
- Deficit financing, describing anticipated composition. **Incomplete.** Deficit financing decomposed at aggregate level.

- Debt stock, including details at least for the beginning of the current year. **Incomplete**. Debt stock reconciliation time is six months.
- Financial Assets, including details at least for the beginning of the current year. **Incomplete**. No such practice.
- Prior year's budget, presented in the same format as the budget proposal. **Complete**. Presented in the budget book—Red Book Annex.
- Current year's budget (either the revised budget or the estimated), presented in the same format as the budget proposal. **Complete**. Presented in the budget book—Red Book Annex.
- Summarized budget data for both revenue and expenditure according to the main heads of the classification used (ref. PI-5), including data for the current and previous year. **Complete**. Budget Speech Annex has the information.
- Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to the expenditure programs. **Complete**. The Budget Speech has the information.

#### ***Indicator 7 (PI-7): Extent of unreported government operations***

*Annual budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public, should cover all budgetary and extra-budgetary activities of central government to allow a complete picture of central government revenue, expenditure, across all categories and financing. This will be the case if (i) extra-budgetary operations (central government activities which are not included in the annual budget law, such as those funded through extra-budgetary funds), are insignificant or if any significant expenditures on extra-budgetary activities are included in fiscal reports, and if (ii) activities included in the budget but managed outside the government's budget management and accounting system (mainly donor-funded projects) are insignificant or included in government fiscal reporting.*

*While donor project funding is partially outside government control (particularly for inputs provided in kind such as that supplied and paid under contracts to which the Government is not a party), ministries, departments and agencies (MDA) in charge of implementing donor-funded projects should at least be able to provide adequate financial reports on the receipt and use of donor funding received in cash. Donor's assistance to the Government in providing full financial information on project support (including inputs in-kind) is assessed in indicator D-2.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) The level of extra-budgetary expenditure (other than donor-funded projects), which is unreported such as that not included in fiscal reports.
- (ii) Income/expenditure information on donor-funded projects, which is included in fiscal reports.

#### **Rating PI-7: C**

#### **Explanation of Score**

- (i) The level of unreported extra-budgetary expenditure (other than donor-funded projects) constitutes 5-10% of total expenditure. (C)
- (ii) Complete income/expenditure information for all loan-financed projects is included in fiscal reports. (C)

## **Justification for Score**

All expenditure, other than donor-funded projects outside the budget are reported, recorded and audited on an annual basis. The levels of some extra-budgetary expenditure are also recorded in the “Weekly Treasury Report”. They added up to 2.31% of total expenditure in FY 2005/06. However, there are expenditures incurred from sources such as Army Welfare Fund, Police Welfare Fund and other development funds/boards, which escape total reporting in the budget and is estimated to range from 5% to 10% of total expenditure.

All expenditure, domestic or otherwise, if it is in the annual budget book is reported, recorded and audited. All loans are reported, recorded and audited but some grant-funded projects are not reflected in the budget. These grant-funded activities—“off-budget”—donor-funded activities, other than those done in agreement with the Ministry of Finance are not audited by the Office of the Auditor General. A recent World Bank study shows that for every dollar spent through the budget \$1.3 is spent outside the budget.

### ***Indicator 8 (PI-8): Transparency of inter-governmental fiscal relations***

*While the performance indicator set is focused on PFM by central government, sub-national governments in many countries have wide-ranging expenditure responsibilities. In federal states, the fiscal relationship between the central (federal or union) government and the individual states is typically established in the constitution of the union or federation. In other cases, specific laws determine the layers of sub-national government, the expenditure responsibilities and revenue-sharing arrangements. Transfers falling in these categories are usually unconditional grants, the use of which will be determined by sub-national governments through their budgets. In addition, central government may provide conditional (earmarked) grants to sub-national governments for implementing selected service-delivery and expenditure responsibilities (function or program) on a case-by-case basis. The overall level of grants (i.e., the vertical allocation) will usually be budget policy decisions at the government's discretion or a part of constitutional negotiation processes and is not assessed by this indicator. However, clear criteria, such as formula for the distribution of grants among sub-national government entities (i.e., horizontal allocation of funds) are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of sub-national expenditure programs. It is also crucial for sub-national governments that they receive firm and reliable information on annual allocations from central government well in advance of the completion (preferably before commencement) of their own budget preparation processes.*

*Given the increasing tendency for primary service delivery to be managed at sub-national government levels, correct interpretation of sectoral resource allocation and actual spending effort require tracking of expenditure information at all levels of government according to sectoral categories (which may or may not correspond to the GFS functional classification), even when this is not the legal form in which the budget is executed. Generation of a full overview of expenditure allocations by general government requires that sub-national governments generate fiscal data with a classification that is comparable to central Government and that such information is collected at least annually and consolidated with central fiscal reports. Sub-national governments may not have obligations to report directly to central government. Collection and consolidation of fiscal data for general government therefore, may not necessarily be undertaken by central government, but rather by a national statistical office. For the coverage to be meaningful, the consolidated reporting of fiscal information should be of a reasonable quality, include all tiers of general government and be presented on both ex-ante (budgeted) and ex-post (actual) basis. Ex-post information should be sourced from routine accounting systems.*

**Dimensions to be assessed (Scoring Method M2):**

- (i) Transparent, and rules based systems in the horizontal allocation among sub-national governments of unconditional and conditional transfers from central government (both budgeted and actual allocations),
- (ii) Timeliness of reliable information to sub-national governments on their allocations from central government for the coming year, and
- (iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.

**Rating PI-8: C****Explanation of Score**

- (i) The horizontal allocation of only a small part of transfers from central Government (10-50%) is determined by transparent and rules based systems. (C)
- (ii) Reliable information to sub-national governments is issued before the start of the sub-national fiscal year but too late for significant budget changes to be made. (C)
- (iii) Fiscal information (at least ex-post) that is consistent with central government fiscal reporting is collected for at the least 60% (by value) of sub-national government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year. (C)

**Justification for Score**

The Local Self Governance Act (LSGA) empowers the local government to implement development activities in accordance with local priorities and is funded through block grants—conditional and unconditional, own resources, loans and foreign aid. At the district level, central Government block grants (vertical allocation) are based on transparent rules: population (20%), total area of district (10%), human development index (50%) and cost index (20%). The budgeted amount for FY2006/07 for (a) District Development Committee (DDC, 75) was NRs.1.05 billion, (b) Municipality (58), NRs.176 million, and (c) Village Development Committee (3,914) was NRs3.9 billion. Dedicated budget lines under 69-3/4-800, 801 and 802 denote unconditional budget transfers from the Government to district, municipality and village-level governments. It is only at the village level that fixed equal amounts of block grants are made by the central Government with fixed norms to sector funding levels and within recurrent and capital accounts. Currently such transfer is fixed at NRs. 1 million for each VDC of which NRs. 0.2 million is recurrent and NRs. 0.8 million is capital expenditure. Issuance of expenditure guidelines and monitoring are done by the Ministry of Local Development (MOLD). These transfers comprise less than 10% of total central Government expenditures. The balance is funded and implemented by central line agencies.

Fiscal year ceiling, including conditional and unconditional grants to DDCs under specified timelines, is rarely followed. Information on budget ceiling communicated to local governments is overdue by about one to two months. However, allocation of conditional grant is approved upon approval of the program by the centre thus limiting the degree of local flexibility in setting priorities. With less than 10% of total local government expenditure coming from local resources, much of their annual plan funding is dictated by tied-fund transfers from the centre. Cognizant of this anomaly, the Government has been making concerted efforts to empower local governments with more unconditional block grants.

The best estimate of unconditional fund was less than 3% of total central Government expenditures in FY2005/06. Similarly, the actual conditional grant released to local bodies in FY2005/06 was 2.84%. Thus, total conditional and unconditional grants released to local bodies was 4.99% of actual central Government expenditures in FY2005/06. The budget allocation to de-concentrated line agencies at the local level has not been included in these expenditures. The remaining 95.01% of Government expenditure is spent by respective line ministry offices and all of that expenditure is audited by OAG. But little is known of expenditures incurred from “own resources” and from non-government/international non-government organizations (NGOs/INGOs) and donor agencies that operate at local level. In some districts this spending could be more than 50% of total local government expenditures.

***Indicator 9 (PI-9): Oversight of aggregate fiscal risk from other public sector entities***

*Central government will usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks with national implications. This includes risks arising from activities of sub-national levels of government, autonomous government agencies (AGA) and public enterprises (PE), including state-owned banks but may also, for political reasons, be obliged to assume responsibility for financial defaults of other public sector entities, where it may have no formal oversight role. Fiscal risks can be created by sub-national governments, AGAs and PEs and inter alia take the form of debt service defaulting (with or without guarantees issued by central government), operational losses caused by unfunded quasi-fiscal operations, expenditure payment arrears and unfunded pension obligations.*

*Central government should require and receive quarterly financial statements and audited year-end statements from AGAs and PEs, and monitor performance against financial targets. AGAs and PEs often report to parent line ministries but consolidation of information is important for overview and reporting of the total fiscal risk for central government. Where sub-national governments can generate fiscal liabilities for central government, their fiscal position should be monitored at least annually, again with consolidation of essential fiscal information.*

*Central government’s monitoring of these fiscal risks should enable it to take corrective measures arising from actions of AGAs, PEs and sub-national governments in a manner consistent with transparency, governance and accountability arrangements, and the relative responsibilities of central Government for the rest of the public sector.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Extent of central government monitoring of AGAs and PEs.
- (ii) Extent of central government monitoring of fiscal position of sub-national governments.

**Rating PI-9: D+**

**Explanation of Score**

- (i) Most autonomous government agencies (AGAs)/Public enterprises (PEs) submit fiscal reports to central governments, at least annually, but a consolidated overview is missing or significantly incomplete. (C)
- (ii) No annual monitoring of the fiscal position of sub-national government takes place or it is significantly incomplete. (D)

## **Justification for Score**

The guidelines under the FAR clearly state that all cost centers need to have their accounts audited. All spending units are also required to complete internal audits. The number of audited accounts in a given year of AGAs and PEs depends upon enforcement of the FAR by the parent ministry and/or MOF. MOF publishes the profit and loss accounts of all major PEs annually (yellow book), covering 90% of government obligations. The status of audited reports of various institutions in 2005 is as follows: (a) Public enterprises 75%, (b) Boards 95 %, and (c) Committees 97%. Although this does not become part of the annual report of the Auditor General (AG), 28 of 36 PEs, 264 of 278 Boards and 366 of 377 committees are audited annually by AG office. Notwithstanding the issue of audit coverage, monitoring and follow-up actions of audit observations by the Government is weak. There exist un-funded quasi-fiscal activities of loss making PEs but the extent of this stock is unknown in any given year.

The Central Treasury System (CTS) is in operation since 2005. While revenue of local government is captured in the CTS, expenditure of local government is yet to be incorporated. Therefore consolidated overview of the net fiscal position is weak owing to the non-capture of local government expenditure, which is less than 8% of total local government expenditures.

### ***Indicator 10 (PI-10). Public access to key fiscal information***

*Transparency will depend on whether information on fiscal plans, positions and performance of the government is easily accessible to the general public or at least the relevant interest groups.*

*The narrative of the assessment should comment on the quality of information made available (e.g. understandable language and structure, appropriate layout and summarized for large documents) and the means used to facilitate public access (such as the press, websites, sale of major documents at no more than the printing cost and notice boards for mainly locally relevant information). The extent to which the means are appropriate depends on the nature of documentation and the characteristic of the relevant interest or user groups, such as access to different media.*

*Elements of information to which public access is essential include:*

- (i) *Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.*
- (ii) *In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.*
- (iii) *Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.*
- (iv) *External audit reports: All reports on consolidated operations of central government are made available to the public through appropriate means within six months of completed audit.*
- (v) *Contract awards: Award of all contracts valued above approximately USD 100,000 equivalent are published at least quarterly through appropriate means.*
- (vi) *Resources available to primary service units: Information is publicized through appropriate means at least annually, available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).*

### **Dimensions to be assessed (Scoring Method M1):**

- (i) Number of the above-listed elements of public access to information that is fulfilled (in order to count, the full specification of the information benchmark must be met).

### **Rating PI-10: B**

#### **Explanation of Score**

- (i) The government makes available to the public 3-4 of the 6 listed types of information.

#### **Justification for Score**

- (i) **Annual budget documentation:** A complete set of documents can be obtained by public through appropriate means when it is submitted to the legislature. **Complete.** Nepal's annual budget documentation for the public is transparent and prompt. All budget-related documents are uploaded on MOF's website immediately upon presentation of the budget in the parliament. These documents include (a) Economic Report, (b) Policy and Aggregate Functional Allocation, Budget Speech, (c) Annual appropriation document – “Red Book-I”, (d) Line item annual appropriation document, “Red Book-II”, (e) Source book or “White Book”, (f) (available within one month after the submission to legislature) the MTEF final document, and (g) (available within two to three months after submission to the legislature) the Annual Appropriation Document by activities and programs (this is available on the website of NPC).
- (ii) **In-year budget execution reports:** Reports are routinely made available to the public through appropriate means within a month of completion. **Complete.** The Central Bank prepares weekly treasury position, which reports the status of release, disbursement, and revenue collection, other receipts and internal borrowings. These reports are not available to the public but are made available to parties interested in budget analysis by FCGO and MOF on demand. Mid-term budget review report is made public. As part of the monthly economic monitoring, the Central Bank makes public fiscal reports, often delayed by 2/3 months.
- (iii) **Year-end financial statements:** The year-end financial statements are made available to the public through appropriate means normally within 12 months of completed audits. **Incomplete.** From 2002 to 2005, these reports were not made public as they were held by the King and because there was no parliament. All of these reports were released together in 2006 but they have not been discussed publicly. There is also a need to improve the submission of year-end financial statements—within six months.
- (iv) **External audit reports:** The situation is same as explained in (iii) above. **Incomplete.** External audit is completed within 9 to 10 months after the end of fiscal year and it takes another 2/3 months for submitting it to the legislature. The role of the Public Accounts Committee (PAC) of parliament is very important for demanding timely submission of audit reports for timely disclosure to the public. How this will evolve remains to be seen.
- (v) **Contract awards:** There is no practice of making public the awarding of contracts other than pinning up of the award notice on the notice board of the implementing agency. **Incomplete.**
- (vi) **Resources available to primary service units:** Information is publicized through appropriate means at least annually or made available upon request for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics). **Complete.** No distinction is made of project or program level activities. All activities are treated as a budget line. Hence, the budget appropriation document contains appropriations for all national activities. Respective ministries can make more detailed information available.

## C. BUDGET CYCLE

### **BUDGET CYCLE - C(i) “Policy-Based Budgeting”**

#### *Indicator 11 (PI-11): Orderliness and participation in the annual budget process*

*While MOF is usually the driver of the annual budget-formulation process, effective participation in the budget formulation process by other MDAs as well as the political leadership, impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies. Full participation requires an integrated top-down and bottom-up budgeting process, involving all parties in an orderly and timely manner, in accordance with a pre-determined budget formulation calendar.*

*The calendar should allow for passing of the budget law before the start of the fiscal year as well as for sufficient time for the MDAs to meaningfully prepare their detailed budget proposals as per the guidance. Delays in passing the budget may create uncertainty about the level of approved expenditures and delays in some government activities, including major contracts. Clear guidance on the budget process should be provided in the budget circular and the budget formulation manual, including indicative budgetary ceilings for administrative units or functional areas.*

*In order to avoid last-minute changes to budget proposals, it is important that the political leadership is actively involved in the setting of aggregate allocations (particularly for sectors or functions) from an early stage of the budget preparation process. This should be initiated through review and approval of the allocation ceilings in the budget circular, either by approving the budget circular or by approving a preceding proposal for aggregate allocations (e.g. in a budget outlook paper).*

#### **Dimensions to be assessed (Scoring Method M2):**

- (i) Existence of an adherence to a fixed budget calendar.
- (ii) Clarity/comprehensiveness of political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent).
- (iii) Timely budget approval by the legislature or similarly mandated body (within the last three years).

#### **Rating PI-11: C+**

#### **Explanation of Score**

- (i) A clear annual budget calendar exists but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time. (B)
- (ii) A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs but before MDAs have completed their submission. (B)
- (iii) The budget has been approved with more than two months delay in two of the last three years. (D)

## **Justification for Score**

Budget Preparation Directory and Budget Operation Manual guide all line ministries/institutions/divisions/departments/programs and projects towards completion of the budget for the coming fiscal year by July 15<sup>th</sup> or earlier (See Annex-3 for dates). Clear dates and timelines are enunciated in the documents. If there are delays, timelines are appropriately corrected through circulars of the MOF Budget Division. Other than approval, the involvement of the political leadership in budget formulation is limited to discussions during the approval process. The limited engagement of the political leadership is an area that needs to be strengthened to ensure ownership of the budget by the people's representatives.

In the absence of parliament (from May 2002-May 2006), the budget was approved by the Cabinet as an ordinance. Generally, the legislature approves the budget within 2 to 3 months of the start of the fiscal year.

### ***Indicator 12 (PI-12). Multi-year perspective in fiscal planning, expenditure policy and budgeting***

*Expenditure policy decisions have multi-year implications and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, medium-term expenditure aggregates for mandatory expenditure and potential deficit financing (including reviews of debt sustainability involving both external and domestic debt) must be the foundation for policy changes.*

*Expenditure policy decisions or options should be described in sector strategy documents which are fully costed in terms of estimates of forward expenditures (both of a recurring nature as well as those involving investment commitments and their recurrent cost implications) to determine whether the new policies are affordable within aggregate fiscal targets. On this basis, policy choices should be made and indicative, medium-term sector allocations be established. The extent to which forward estimates include explicit costing of the implication of new policy initiatives, involve clear, strategy-linked selection criteria for investments and are integrated into the annual budget-formulation process will then complete the budget policy link.*

### **Dimension to be assessed (Scoring Method M2)**

- (i) Preparation of multi-year fiscal forecast and functional allocations.
- (ii) Scope and frequency of debt sustainability analysis (DSA).
- (iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure.
- (iv) Linkages between investment budget and forward expenditure estimates.

### **Rating PI-12: C+**

#### **Explanation of Score**

- (i) Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classifications) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained. (B)
- (ii) A DSA for at least for external debt undertaken once during last three years. (C)
- (iii) Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure or costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts. (C)

- (iv) Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases. (C )

### **Justification for Score**

Poverty Reduction Strategy (PRS) or the Tenth Plan is fiscally anchored by MTEF. The first year of the MTEF is the budget and forward forecasts set the ceiling for the coming two years. Although disaggregate sectoral and sub-sectoral ceilings are also enunciated in the MTEF, the leeway for staying above and below ceiling at sectoral levels is subject to fund availability, provided the budget aggregate holds. The aggregate budget ceiling constraint was not adhered to in only one of the last four years.

Domestic debt recording and reporting are done by the Central Bank and through a dedicated debt servicing unit at FCGO. External debts, upon receiving reports from respective donor agencies, are properly recorded at the aforesaid unit at FCGO. Although debt sustainability analysis is not routinely carried out by Government, external agencies—International Monetary Fund (IMF) and the World Bank—routinely carry out DSA reports which are shared with Government.

Only two sectors, education and health, have approved sector strategies with cost estimates and investments linked to forward estimates. The spending of the two sectors constitutes 22% of total expenditure or 68% of social sector spending. In view of the coverage and activities of these two sectors being primary by nature, this third dimension is rated as “C”.

In the absence of coherent approved sector strategies, the periodic plan has loose cost estimates although some activities have estimates to the unit level. Except for education and health sector strategies, Nepal lacks sector strategies with cost estimates. Therefore, linkages between sector strategies, investment budget and forward expenditure estimates are, at best, weak and questionable.

## **BUDGET CYCLE - C(ii) “Predictability and Control in Budget Execution”**

### ***Indicator 13 (PI-13). Transparency of taxpayer obligations and liabilities***

*Effective assessment of tax liability is subject to the overall control environment that exist in the revenue administrative system (ref. PI-14) but is also very dependent on direct involvement and cooperation of individual and corporate taxpayers. Their contribution to ensuring overall compliance with tax policy is encouraged and facilitated by a high degree transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard and the ability to contest administrative rulings on tax liability.*

*A good tax collection system encourages compliance and limits individual negotiation of tax liability by ensuring that tax legislation is clear and comprehensive and that it limits discretionary powers (especially in decisions on tax assessment and exemptions) of the government entities, such as the revenue administration, MOF and investment promotion agencies.*

*It should be noted that a country’s revenue administration may comprise several entities, each of which has revenue collection as its principal function (e.g. an inland revenue agency and customs authority). Where relevant, all those entities should be included in the assessment of the revenue related indicators PI-13, PI-14 and PI-15.*

*Taxpayer education is an important part of facilitating taxpayer compliance with registration, declaration and payment procedures. Actual and potential taxpayers need easy access to user-friendly, comprehensive and up-to-date information on the laws, regulations and procedures (e.g. posted on government websites, made available through taxpayer seminars, widely-distributed*

*guidelines/pamphlets and other taxpayer education measures). Potential taxpayers also need to be made aware of their liabilities through taxpayer education campaigns.*

*The ability of taxpayers to contest decisions and assessment made by the revenue administration requires the existence of effective complaints/appeals mechanisms that guarantee the taxpayer a fair treatment. The assessment of tax appeals mechanism should reflect the existence in practice of such a system, its independence in terms of organizational structure, appointments and finance; its powers in terms of having its decisions acted upon as well as its functionality in terms of access (number and sizes of cases), efficiency (case processing period) and fairness (balance in verdicts).*

**Dimensions to be assessed (Scoring Method M2):**

- (i) Clarity and comprehensiveness of tax liabilities.
- (ii) Taxpayer access to information on tax liabilities and administrative procedures.
- (iii) Existence and functioning of a tax appeals mechanism.

**Rating PI-13: C+**

**Explanation of Score**

- (i) Legislation and procedures for some major taxes are comprehensive and clear but the fairness of the system is questioned due to substantial discretionary power of government entities involved. (C)
- (ii) Taxpayers have access to some information on tax liabilities and administrative procedures but the usefulness of the information is limited due to coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date. (C)
- (iii) A tax appeals system of transparent administrative procedures is completely set up and functional. But it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow-up on its decisions, need to be addressed. (B)

**Justification of Score**

Legal provisions for major taxes are comprehensive and clear but the fairness of the system is questionable because of perceived discretionary power of government entities, especially on decisions related to liquor and excise. For all major tax streams—customs, Value-added Tax (VAT), Excise and Income Tax—there are rules and regulations for the individual taxes. But when it comes to arbitration, the tax officer's judgmental decision is final for collection though there is space for legal redress at a later date.

The law is clear but at times there have been confusions in liquor sector taxation, especially on which law to apply—Excise or Liquor Act. Additionally, both the excise and liquor acts are silent on procedures and penalties on production/sale of illegal liquor resulting in discretionary decisions.

The text of the Income Tax Act is said to be complex and difficult to understand, leading to confusions. The Finance Act does clarify some of the ambiguities. The VAT law is comprehensive and clear, and limits discretionary power of assessment officers.

Taxpayers have access to some information on tax liabilities and administrative procedures but the usefulness of the information is limited. Legal terms, understood mostly by lawyers only, remain as the main hurdles and therefore all tax liability procedures are not user-friendly from the taxpayers' perspective.

**Excise:** Information on tax liabilities are submitted by the taxpayers following clear administrative procedures. However, comprehension and comprehensiveness are still issues needing further improvement.

**Income Tax:** Taxpayers have access to information or data on their businesses, which comes from different sources. Physical presence of taxpayer is necessary for accessing the information. Taxpayers are also informed of additional liabilities through statements upon completion of tax audits.

**VAT:** Like with the income tax, tax payers have access to information and their additional liabilities are notified upon completion of tax audits. Access to customs information is limited.

There is a system for tax appeal but transparency, fairness and effectiveness are questionable when tax arbitration is slow and can take more than a year for resolution, resulting in substantial financial costs. The provision for administrative review exists for all major taxes: Excise, Income Tax, VAT and Customs (Valuation). Nepal also has a Judicial Tribunal. But questions have been raised on delays in decision making and implementation, resulting in low compliance. The tax appeal system needs strengthening.

Nepal does not have special benches to hear and resolve commercial disputes. The use of internet for filing returns and other tax services also need to be developed and/or enhanced. Enforcement of court decisions is not timely.

#### ***Indicator 14 (PI-14). Effectiveness of measures for taxpayer registration and tax assessment***

*Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers.*

*Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration. Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system but is most effective if combined with other government registration systems that involve elements of taxable turnover and assets (such as issuance of business licenses, opening of bank accounts and pension fund accounts). In addition, revenue administration should ensure compliance with registration requirements through occasional surveys of potential taxpayers e.g. by selective, physical inspection of business premises and residences.*

*Ensuring that taxpayers comply with their procedural obligations of taxpayer registration and tax declaration is usually encouraged by penalties that may vary with the seriousness of the faults. Effectiveness of such penalties is determined by the extent to which penalties are sufficiently high to have the desired impact and are administered consistently and fairly.*

*Modern revenue administration rely increasingly on self-assessment and use risk-targeted auditing of taxpayers as a key activity to improve compliance and deter tax evasion. Inevitable resource constraints mean that audit selection processes must be refined to identify taxpayers and taxable activities that involve the largest potential risk of non-compliance. Indicators of risk are the frequency of amendments to returns and additional tax assessed from tax audit work. Collection and analysis of information on non-compliance and other risks is necessary for focusing tax audit activities and resources towards specific sectors and types of taxpayers have the highest risk of revenue leakage. More serious issues of non-compliance involve deliberate attempts of tax evasion and fraud, which may involve collusion with representatives of revenue administration. The ability of the revenue administration to identify, investigate and successfully prosecute major evasion and fraud cases on a regular basis is essential for ensuring that taxpayers comply with their obligations.*

**Dimensions to be assessed (Scoring Method M2):**

- (i) Controls in the taxpayer registration system.
- (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations.
- (iii) Planning and monitoring of tax audit and fraud investigation programs.

**Rating PI-14: C**

**Explanation of Score**

- (i) Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. (C)
- (ii) Penalties for non-compliance generally exist but substantial changes to their structure; levels or administration are needed to give them a real impact on compliance. (C)
- (iii) There is a continuous program of tax audits and fraud investigations but audit programs are not based on clear risk assessment criteria. (C)

**Justification for Score**

**Controls in the taxpayer registration system.** Nepal launched the taxpayer identification (Permanent Account Number or PAN) scheme with the implementation of new income tax law in 2001. Compulsory VAT registration for all importers, exporters and retailers above the threshold, has been implemented. Necessary permissions are granted for transactions in liquor and excise-dutiable products upon request. As PAN was introduced for income tax, it has limited linkages with other taxes (excise, VAT and customs). Except for customs, efforts are underway to link all databases of Inland Revenue (excise, VAT and Income Tax) but full integration will take some time.

**Effectiveness of penalties for non-compliance with registration and tax declaration.** Penalties for non-compliance exist for most relevant taxes but are not always effective due to inconsistent administration. Heavy penalties are prescribed in the laws for income tax, excise, VAT and customs violations but compliance is low resulting in heavy leakages and non-collection. Non filers of income tax are penalized up to NRs.1,000 annually with 15% interest for defaulted payment. Similarly non-VAT filers are charged NRs.1,000 per month with 15% interest on defaulted payment.

**Planning and monitoring of tax audit programs.** Tax audits are conducted—2% of total tax filed—and fraud is investigated on an ad hoc basis. This, however, applies only for income tax and VAT. Audit programs are not based on clear risk assessment criteria. For VAT audit it is up to 10% based on tax audit number provided by the Inland Revenue Department. Although internal, external and independent audits are in place, legal provisions for appeal and reassessment have, at times, resulted in delays in payment. Likewise, fraud investigations are conducted on the basis of (a) high risk area, (b) reported/published news, (c) complaints from the general public, and (d) directives received from oversight agencies. In excise, self-renewable inspection system and direct control of tax administration on liquor production, helps in tax audits.

**Indicator 15 (PI-15). Effectiveness in collection of tax payments**

*Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, which the ability to collect outstanding tax debt lends credibility to the assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily and need close follow-up. The level of tax arrears itself does not necessarily correlate to the effectiveness of the tax collection system, since a major tax assessment drive may substantially increase tax arrears. However, the revenue*

*administration's ability to collect the taxes assessed is critical, unless the overall level of arrears is insignificant. Part of the arrears collection effort relates to resolution of disputed taxes. In some countries, tax arrears in dispute constitute a significant part of the total tax arrears, which is why there may be major differences between gross and net arrears (including and excluding disputes respectively).*

*Prompt transfer of the collection to the Treasury is essential for ensuring that the collected revenue is available to the Treasury for spending. This may take place either by having a system that obliges taxpayers to pay directly into accounts controlled by Treasury (possibly managed by bank) or, where the revenue administration maintains its own collection accounts, by frequent and full transfers from those accounts to Treasury-controlled accounts (time periods mentioned do not include delays in the banking system).*

*Aggregate reporting on the tax assessments, collections, arrears and transfers to (and receipts by) the Treasury must take place regularly and be reconciled where appropriate, in order to ensure that the collection system functions as intended, that tax arrears are monitored and the revenue float is minimized.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).
- (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.
- (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.

#### **Rating PI-15: D+**

#### **Explanation of Score**

- (i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collection). (D)
- (ii) Revenue collections are transferred to the Treasury at least weekly. (B)
- (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay. (D)

#### **Justification for Score**

The revenue debt collection ratio in FY2004/05, was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collection). The average debt collection ratio, in FY2003/04 and FY2004/05 was 60-75% and the total amount of tax arrears is significant.

**Table 2.5: Revenue Debt (NRs. Million)**

Fiscal Year	Arrears	Increment (%)
2002/03	35,876	6.59
2003/04	28,015	(21.91)
2004/05	28,998	3.51

*Source: OAG Annual Report 2006*

**Table 2.6: Revenue Type Arrears (NRs. Million)**

Fiscal Year	Total	%	Income tax	%	Vat	%	Excise	%
2001/02	8,192		5,219		2,771		202	
2002/03	8,272	0.97	5,247	0.53	2,794	0.83	231	14.35
2003/04	5,597	(32.33)	4,209	(19.78)	1,185	(57.58)	203	(12.12)
2004/05	9,559	70.78	5,491	30.45	1,662	40.25	2,406	1085.22

Source: IRD Annual Report 2004/05

Revenue collections are transferred to the Treasury daily. A weekly consolidated Treasury report is also prepared.

Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place annually but it takes three months after the end of the year for reconciliation to be completed.

**Indicator 16 (PI-16). Predictability in the availability of funds for commitment of expenditures**

*Effective execution of the budget, in accordance with the work plans, requires that the spending MDAs receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the central MOF provides reliable information on the availability of funds to the users who manage administrative (or program) budget heads in the central government budget and therefore are primary recipients of such information from MOF. The MDAs in this indicator are the same as those in PI-11.*

*In some systems, funds (commitments ceilings, authority to spend or transfer of cash) are released by MOF in stages within the budget year (monthly, quarterly, etc.). In others, the approval of the annual budget law grants full spending authority at the beginning of the year; the MOF (or other central agency) may in practice impose delays on ministries in incurring new commitments (and making related payments) when cash flow problems arise. To be reliable, the amount of funds made available to an entity for a specific period should not be reduced during that period.*

*Predictability for MDAs of fund availability is facilitated by effective cash flow planning, monitoring and management by the Treasury based on regular and reliable forecasts of inflows and of major, atypical outflows (such as the cost of holding an election and discrete capital investments) which are linked to budget implementation and commitment plans of individual MDAs, and incorporates the planned in-year borrowing to ensure adequate liquidity at any time.*

*Governments may need to make in-year adjustments to allocations in light of unanticipated events impacting revenues and/or expenditures. The impact on predictability and on the integrity of original budget allocations is minimized by specifying, in advance, an adjustment mechanism that relates adjustment to budget priorities in systematic and transparent manner (e.g. protection of particular budget lines that are declared to be high priority, or say "poverty related"). In contrast, adjustments can take place without clear rules/guidelines or can be undertaken informally (e.g. through delays on new commitments). While many budget adjustments can take place administratively with little implication for the expenditure composition outturn at the more aggregate level of budget classifications, other more significant changes may change the actual composition at fairly aggregate administrative, functional and economic classification levels. Rules for when the legislature should be involved in such in-year budget amendments are assessed in PI-27 and are not covered here.*

*The adherence of MDAs with the ceilings for expenditure commitment and payments is not assessed here, but is covered by indicator PI-20 on internal controls.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Extent to which cash flows are forecast and monitored.
- (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.
- (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.

**Rating PI-16: C+**

**Explanation of Score**

- (i) A cash flow forecast is prepared for the fiscal year but is not (or only partially and infrequently) updated. (C)
- (ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance. (B)
- (iii) Significant in-year budget adjustments are frequent but undertaken with some transparency. (C )

**Justification for Score**

MDA's are able to plan and commit expenditures for at least six months in advance in accordance with the budgeted appropriations. A consolidated cash flow forecast is prepared for the fiscal year at the beginning of the year. Though formal forecast of cash flow reports are not prepared during the year, monthly stock taking of actual cash inflows and outflows on the basis of the "Weekly Treasury Reports" and "Monthly Revenue Collection Achievement" reports become basis for projecting forward cash flow requirements. Trimester release of funds based on achievement, as noted in "Budget Form Number 2", is the basis for MDAs to plan execution in accordance with the budgeted appropriations.

MDAs are provided advance, reliable information at least quarterly. Categorization of all budget lines in priority—P1, P2, P3—is one tool used by MOF to not only ensure predictability but to also manage cash position of the Treasury. All P1 projects/activities funds are secured. Aggregate cash budget availability is tied to the ceiling of budgetary amounts of P1 projects, thus ensuring fund predictability and availability for all P1 projects.

Significant in-year adjustments to budget are frequent, but are undertaken with some transparency. There are transparent rules of adjustment and virement from one budget heading to another and one source of financing to the other. The adjustment and virement of the allocated budget are provisioned not on the basis of frequency but as per a percentage of the budget and nature of the headings, to the Office Head, Departmental Head, Secretary and MOF (FAR Rule 39). The allowable percentage of virement is 25 % of the budget line. MOF, with sufficient justification, does at times allow virement above this level to the secretary of the line ministry.

***Indicator 17 (PI-17): Recording and management of cash balances, debt and guarantees***

*Debt management in terms of contracting, servicing and repayment, and the provision of government guarantees are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt service costs and can create significant fiscal risks. The maintenance of a debt data system and regular reporting of the main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments and well-planned debt roll-over.*

*An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated (including those for extra-budgetary funds and government-controlled projects accounts). Calculation and consolidation of bank accounts are facilitated where a single Treasury account exists or where all accounts are centralized. Timely electronic clearing and payment arrangement with the government's bankers will generally be required for achieving regular consolidation of multiple bank accounts not held centrally.*

*Critical to debt management performance are also the proper recording and reporting of government issued guarantees, and the approval of all guarantees by a single government entity (e.g. the MOF or a debt management commission) against adequate and transparent criteria.*

*Undertaking of debt sustainability analyses is covered under multi-year perspectives in PI-12, whereas monitoring of liabilities arising from guarantees issued is covered under fiscal risk oversight in PI-9.*

**Dimensions to be assessed (Scoring Method M2):**

- (i) Quality of debt data recording and reporting.
- (ii) Extent of consolidation of governments' cash balances.
- (iii) Systems for contracting loans and issuance of guarantees.

**Rating PI-17: C+**

**Explanation of Score**

- (i) Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content. (C)
- (ii) Most cash balances are calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement. (B)
- (iii) Central government's contracting of loans and issuance of guarantees are always approved by a single responsible entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings. (C)

**Justification for Score**

A dedicated unit at FCGO regularly updates both domestic and foreign debt. Although, it has software (CSDRMS) to help facilitate debt management, operational problems have resulted in recording debt manually. Debt, stock and flow are reported annually in the Economic Survey report.

Major cash balances are calculated weekly and are reflected in the Weekly Treasury Report. Local government revenues are recorded but expenditures (not more than 8% of the total spending) are outside the recording systems.

The Foreign Aid Policy 2002 restricts any form of government guarantee—the last such agreement was done 10 years ago. The National Debt and Guarantee Act is the basis of borrowing and is amended at the beginning of the fiscal year.

### **Indicator 18 (PI-18): Effectiveness of payroll controls**

*The wage bill is usually one of the biggest items of government expenditure and is susceptible to weak control and corruption. This indicator is concerned with payroll for public servants only. Wages for casual labor and discretionary allowances that do not form part of the payroll system are included in the assessment of general internal controls (PI-20). However, different segments of the public service may be recorded in different payrolls. All of the more important of such payrolls should be assessed as the basis for scoring this indicator mentioned in the narrative.*

*The payroll is underpinned by a personnel database (in some cases called the “nominal roll” and not necessarily computerized), which provides a list of all staff who should be paid every month and which can be verified against the approved establishment list and the individual personnel records (or staff files). The link between the personnel database and the payroll is a key control. Any amendment required to the personnel database should be processed in a timely manner through a change report, and should result in an audit trial. Payroll audits should be undertaken regularly to identify ghost workers, fill data gaps and identify control weaknesses.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Degree of integration and reconciliation between personnel records and payroll data.
- (ii) Timeliness of changes to personnel records and the payroll.
- (iii) Internal controls of changes to personnel records and the payroll.
- (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.

#### **Rating PI-18: C+**

#### **Explanation of Score**

- (i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months. (C)
- (ii) Up to three months delay occurs in updating of changes to the personnel records and payroll but affects only a minority of changes. Retroactive adjustments are made occasionally. (B)
- (iii) Controls exist but are not adequate to ensure full integrity of data. (C)
- (iv) A payroll audit covering all central Government entities has been conducted at least once in the last three years (whether in stages or as one single exercise). (B)

#### **Justification for Score**

Electronic Personnel Information System of Government is complete—teachers (90% complete) and police (80% complete). Personnel records assist in linking the database and the payroll. This, at best, covers two thirds of total payroll subjected to budget appropriation. Although it is mandatory to pass the “salary report” by each office for budget appropriation for the fiscal year, discrepancies in linking posts to payroll exist mainly because of the aforesaid reasons. Personnel records and payroll data are reconciled at least once every six months, generally at the beginning of the fiscal year and at the time of audit.

Payroll data are audited internally every month and it is audited annually by the OAG. Personnel and payroll data are not directly linked yet but the payroll is supported by full documentation for all changes made to personnel records each month and is checked against the previous month’s payroll data. Further, changes to the payroll and nominal roll are updated monthly, generally in time for the following month’s payments. Retroactive adjustments are rare (maximum, 3% of salary payments).

Personnel records are maintained by the Civil Personnel Office. It is also maintained at the ministry where the person is working but reconciliation problems do exist. Although there is ambiguity in the process of recording grade (increments each year for different rates of grades are difficult to compute) no such anomaly exists in the scale. Scale constitutes 90% of total payroll.

Internal payroll audits are conducted on a monthly basis by the District Treasury Controller Office (DTCO); they are audited on an annual basis by an external auditor—the Office of the Auditor General. Payroll audit hardly exists and workers are mostly paid under the civil works budget, thus creating the probability of ghost workers.

***Indicator (PI-19): Competition, value for money and controls in procurement***

*Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for, and value for money, in delivery of programs and services by the government. This indicator focuses on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method and defines alternatives to open competition that may be appropriate when justified in specific, defined situations.*

*The procurement system benefits from the overall control environment that exists in the PFM system, including internal controls operated by implementing agencies and external control, undertaken by external audit (PI-20, PI-21, PI-22 and PI-26).*

*Unique to the public procurement process, however, is the direct involvement of participants from the private sector who, along with citizens, are direct stakeholders in the outcome of the procurement process. A good procurement system uses the participation of these stakeholders as part of the control system by establishing a clear regulated process that enables the submission and timely resolution of complaints submitted by private sector participants. Access to the process and information on complaints allows interested stakeholders to participate in the control system.*

**Dimensions to be assessed (Scoring Method M2):**

- (i) Evidence on the use of open competition for award of contracts that exceeds the nationally established monetary threshold for small purchases (percentage of the number of contracts that are above the threshold).
- (ii) Extent of justification for use of less competitive procurement methods.
- (iii) Existence and operation of a procurement complaints mechanism.

**Rating I-19: C**

**Explanation of Score**

- (i) Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate. (C)
- (ii) Justification for use of less competitive methods is weak or missing. (C)
- (iii) A process exists for submitting and addressing procurement complaints but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints. (C)

## **Justification for Score**

Although, generally, open competition is mandatory for procurement, there is no system to maintain data. Data are generally available at the project or entity level for donor-financed projects, showing that more than 75% of contracts above the threshold are awarded on the basis of open competition. But this information is not tracked systematically. Volume of procurement undertaken through the Government's own funds is proportionately large and hence, on aggregate, it is estimated that less than 50% of contracts above the threshold are awarded on an open competitive basis. However, there is no basis to confirm or ignore this estimate.

The Procurement Regulations, under the Public Procurement Act, have established necessary conditions and thresholds for different procurement methods. The following are the prescribed methods of public procurement (for works):

- (a) Through open (competitive) bidding for all procurements valued at more than one million Nepali rupees,
- (b) Through call for sealed quotations (which is a mini-tendering, difference being only in the time frame and the documentation) for a procurement up to Rs.1 million;
- (c) Direct contracting through negotiation for works and off-the-shelf purchases of goods costing up to Rs.150,000 and for services costing up to Rs.100,000;
- (d) Through contracting of users groups or beneficiary communities; and
- (e) Force account.

The pre-qualification exercise is prescribed for large and complex works, installations and other activities as decided by the procuring entity. The conditions for the use of the above methods are fairly clear and open competitive bidding is the method envisaged by the regulations. There is a practice of slicing procurement into smaller packages in order to avoid the open bidding thresholds, especially in road, irrigation, forestry and agriculture sectors. This has been controlled to some extent over the past few years—owing to observations and oversight of OAG and CIAA. The new law (*Clause 8*) prohibits breaking jobs into smaller procurements that results in limited competition. The Public Procurement Act (*Clause 9*) requires the open competitive bidding to be the preferred and expected method.

The Public Procurement Act has a formal complaints or appeals mechanism (*Clauses 48 through 51*). The law spells out the procedure for reviewing complaints with timeframe for appeals by the bidders and decision making by the Review Committee. The law includes provisions for having a code of conduct for the personnel of Employer/Purchaser (*Clause 61*) and that of the Bidder/Proposer (*Clause 62*). Since the Act was approved only in January 2007, it has not yet been implemented effectively. How the formal complaint system will function thus remains to be seen. The implementation of the law also remains to be tested.

### ***Indicator 20 (PI-20): Effectiveness of internal controls for non-salary expenditures***

*An effective internal control system is one that (a) is relevant (i.e. based on an assessment of risks and the controls required to manage the risks), (b) incorporates a comprehensive and cost effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting), (c) is widely understood and complied with, and (d) is circumvented only for genuine emergency reasons. Evidence of the effectiveness of the internal control system should come from government financial controllers, regular internal and external audits or other surveys carried out by management. One type of information could be error or rejection rates in routine financial procedures.*

*Other indicators in this set cover controls in debt management, payroll management and management of advances. This indicator, therefore, covers only the control of expenditure commitments and payment for goods and services, casual labor wages and discretionary staff allowances. The effectiveness of expenditure commitment controls is singled out as a separate dimension of this indicator due to the importance of such control for ensuring that the Government's payment obligations remain within the limits of projected cash availability, thereby avoiding creation of expenditure arrears (See: PI-4).*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Effectiveness of expenditure commitment controls.
- (ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures.
- (iii) Degree of compliance with rules for processing and recording transactions.

**Rating I-20: C**

**Explanation of Score**

- (i) Expenditure commitment control procedures exist but are partially effective, but they may not comprehensively cover all expenditures, or they may be occasionally violated. (C)
- (ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance. (C)
- (iii) Rules are complied with in a significant majority of transactions but use of simplified/emergency procedures in unjustified situations is an important concern. (C)

**Justification for Score**

The Financial Procedure Act 1999 and FAR 1999 and subsequent amendments have described provisions on formulation, approval and execution of budget. Secretaries of concerned line ministries and the Chief Accounting Officers are accountable for implementing government policies and programs. Authority to implement the Appropriation Bill is provided by the Finance Secretary to the secretaries of various line ministries, who subsequently delegate the authorization of budget implementation to departmental heads and eventually office chiefs. Although expenditures in general, are incurred within the allocated budget, there are some fairly frequent exceptions including, incurring expenditures without sufficient budget and without formal budget transfer and virement. There is a system to monitor and control expenditures within the approved budget allocation—monthly financial statements are prepared showing amount available, expenditures and the balance. Expenditure commitment control systems exist and they are partially effective. There is a provision for approving the Advance Bill in case the parliament is unable to approve the Appropriation Bill before the fiscal year begins. There also exists a provision to release one-sixth of the previous year's recurrent expenditure in the form of Imprest Fund if the authorization letter is not transmitted to spending units on the first day of the fiscal year. According to the prevailing system, replenishment of Imprest Fund is not allowed unless the authorization for expenditure is made available to spending units. Fund release takes place as authorized in the letter. For capital expenditures, one-third of the total authorized fund is released in the form of Imprest Fund for P1 projects. Fund release is performance-based. Although there is a good procedure for expenditure commitment control, enforcement, especially, during the last trimester of the fiscal year is violated often in the name of crisis and emergency. Such cases are generally noted in audit observations.

The Financial Procedures Act, 1999 and the FAR 1999 (amended in 2001, 2003 and 2007) specify the responsibilities of MOF, FCGO and DTCO, other central-level agencies and operation-level entities. They prescribe financial procedures relating to collection, disbursement, recording, internal

control, checking, internal auditing, independent audit by OAG and the clearing of irregularities. In practice, internal control comprises check and balance from concerned authorities, inspection by senior authority and internal audits. Budget allocation, authorization and control, sanction from authorized officials, record keeping and reconciliation and financial reporting are the elements of the internal control system.

For decentralized authorities, the Local Self Governance Act (LSGA) 1999, Section 3 (a) states that the Government will devolve necessary authority, responsibilities and resources to local bodies for making them capable and effective in local self governance. In accordance with the devolution policy, the line ministries delegate both program and budget authority to the secretary of DDC. Line agencies under the devolution scheme draw their fiscal authority for running annual programs through DDC. Beginning from mid-July 2005, funds have been channeled through District Development Fund (DDF) including district-level funding for subject programs devolved under health (essential health care services), agriculture (extension services for agriculture and livestock) and education (salary of primary school teachers). The secretary of DDC re-delegates program and budget authority to line agency chiefs, and releases funds on demand. The Local Self Governance Regulations require pre-auditing from the internal auditor in each payment exceeding NRs.50,000. The authority and chief of the account section bear responsibility to ensure, prior to summons by the final auditor that irregularities pointed out by the internal auditor are duly complied with. The chief of the account section is responsible to safeguard check book, cash and bank deposits, receipts and records. Likewise, the storekeeper safeguards physical assets. The local body authority or designated nominees conduct stock verification at least once every year. The procedures are prescribed in the regulations. In 2000, the Ministry of Local Development (MOLD) provided internal audit guidelines (draft) to the local bodies but they were not implemented. By-laws have been formulated pursuant to Rule 265 of the Local Self-Governance Act, 1999 to provide detailed operational guidelines on procedures relating to financial administration, personnel management and creation of local body fund. Transactions are to be counter-checked and recorded upon approval by the chief.

The effectiveness of controls—including pre-audit and internal audit—can be inferred from the results of the Auditor General’s Report. The Auditor General’s Report of 2005 on performance audit of the internal audit function has strongly advocated the need for making the audit more effective. It has suggested some key reforms: (1) prepare internal audit plan and field internal audit team under the leadership of gazetted officer to carry out the audit (2) review the positions of internal audit staff and ensure that all positions are fulfilled by qualified staff (3) ensure the quality of internal audit by developing expertise of in-house staff or by contracting out this function to qualified experts or auditors, and (4) institutionalize the internal audit training program in order to develop the capacity in internal auditing. In addition, it has also suggested specifying benchmarks to measure the performance of internal audit, to formulate necessary legislation for reforming internal audit, to review the adequacy of internal control mechanisms in the process so that necessary measures could be taken by implementing agencies for improving the accountability system, and to have internal audits of all revenue collecting entities.

With regard to degree of compliance with rules for processing and recording transactions, the Auditor General reports for FY2001/02 to FY2004/05 indicate that the percentage of irregularities has decreased from 9% to 6% of total transaction. Further, the proactive roles of oversight agencies such as the CIAA have created awareness among Government employees on the need for compliance-oriented decision making. Most government departments have introduced Working Procedures to ensure compliance in decision making. Public offices have also introduced citizen charters and nodal officers for monitoring compliance with rules. Books of accounts in all public offices are maintained by the accounting staff. Judiciary services are provided by the legal staff associated with the Ministry of Law and Justice and the OAG. In general, rules are judiciously followed in all disciplines, but use of simplified/emergency procedures in unjustified situations (observed during the conflict years) remains an important concern.

### **Indicator 21 (PI-21): Effectiveness of internal audit**

*Regular and adequate feedback to management is required on the performance of the internal control systems through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards such as the International Standards for the Professional Practice in Internal Audit (ISPPIA), in terms of (a) appropriate structure, particularly with regard to professional independence; (b) sufficient breadth of mandate, access to information and power to report, and (c) use of professional audit methods, including risk assessment techniques. The function should be focused on reporting on significant systemic issues in relation to: reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets and compliance with laws, regulations and contracts. Internal audit functions are in some countries concerned only with pre-audit of transactions, which is here considered part of the internal control system and therefore assessed as part of indicator PI-20.*

*Specific evidence of an effective internal audit (or systems monitoring) function would also include a focus on high risk areas, use by the Supreme Audit Institute (SAI) of the internal audit reports and action by management on internal audit findings. The latter is of critical importance since lack of action on findings completely undermines the rationale for the internal audit function.*

*The internal audit function may be undertaken by an organization with a mandate across entities of the central government (such as government inspection general of IGF) or by separate internal audit functions for individual government entities. The combined effectiveness of all such audit organizations is the basis for this indicator.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Coverage and quality of the internal audit function.
- (ii) Frequency and distribution of report.
- (iii) Extent of management response to internal audit findings.

#### **Rating I-21: D+**

#### **Explanation of Score**

- (i) There is little or no internal audit focused on systems monitoring. (D)
- (ii) Reports are issued regularly for most government entities but may not be submitted to MOF and the SAI. (C)
- (iii) Internal audit recommendations are usually ignored (with few exceptions). (D)

#### **Justification for Score**

The internal audit is being conducted by the separate unit of FCGO according to the requirement of the Financial Procedure Act, 1999 and FAR, 1999 (later amended). According to Rule 142 (6), “The Financial Comptroller General Office and the concerned District Treasury and Controller Office may, on a spot check or from time to time, examine as to whether the books of account required to be maintained by any office have been maintained accurately or not, whether cash balance is accurate or not.” All irregularities reported in the internal audit reports should either be resolved before start of the external audit or written justification for unresolved irregularities should be submitted to the external auditor. The irregularities reported in the internal audit will not be valid after completion of the external audit.

The LSGA (Clause 135) together with Rule 30 of the Local Self-Governance Regulations, 1999 prescribe that municipality should set up internal audit sections, headed by an Internal Auditor (officer level) in cases where the revenue exceeds NRs.10 million. Likewise, the Clause 232 of LSGA, in conjunction with Rule 48, prescribes the type of Internal Audit set up within DDCs i.e. Internal Auditor (officer level) and support staff other than for those located in remote areas. As a result, internal audit sections have been created in 65 DDCs.

Internal audits are carried out on a regular basis, mostly bi-monthly. Reports are regularly submitted to the chiefs of concerned spending units but may not necessarily be submitted to MOF or OAG. Internal audit reports are generally weak and not focused on the risk management perspective. Very little observations are made on the performance of internal control systems. There is no structure with regard to professional independence of the internal auditors. Internal audit function is one of the functions of FCGO, which also administers the accountants, and is responsible for submitting consolidated accounts to the Auditor General. There is a conflict of interest in carrying out effective internal audit since the same accounting staffs rotate to carry out both accounting and internal audit functions. Internal auditors do not use professional audit methods or follow a risk-based approach. The scope of work under internal audit is also not defined properly. Code of ethics for internal auditors does not exist. The concept of internal audit committee has not yet been introduced. Capacity in internal audit is a major constraint affected by lack of trained and skilled human resources and inadequate motivation and incentives for carrying out meaningful internal audit. Capacity is even weaker in local governments and the internal audit system as required by local FAR has not yet been institutionalized.

Professionalism has yet to develop as regards internal audit. Management requires regular and adequate feedback on the performance of internal control systems through an internal audit function (or equivalent system monitoring function). Such a function should meet international standards such as the ISPPA, in terms of (a) appropriate structure particularly with regard to professional independence, (b) sufficient breadth of mandate, access to information and power to report, and (c) use of professional audit methods, including risk assessment techniques. The Auditor General reports have frequently questioned the quality and effectiveness of internal audit system.

FCGO prepared the Internal Audit Manual about 10 years ago and it has been updated but it still does not meet the desired professional standards. Quality audits help to identify measures to eliminate or reduce waste and inefficiency in mobilization of public resources, to create public awareness on good governance, to recommend improvement of policies and procedures and to sharpen the process of public accountability. Emerging changes in technology and growing demands from the public and donors for public accountability and good governance are putting pressure on OAG to be more proactive, quality conscious and oriented to serving the public interest. It is important to upgrade the timeliness and quality of internal audit in order to ensure timely and quality external audit. That would allow the Auditor General to rely more on a strong, well-functioning internal audit system. Currently, although the regulations require that all irregularities reported in the internal audit reports should be resolved before start of the external audit, it remains as a percept, while it is not happening as required by the Regulations. A number of reforms is envisaged in internal audit including, making it an independent function though a specified cadre of staff motivated to carry out only the function, without rotating staff to also carry out accounting, developing risk-based approach in compliance with acceptable professional standards, defining a separate code of ethics for internal auditors and institutionalizing an in-country training program. The Government is committed to implement these reforms for addressing the deficiency in one of the core indicators of public financial management. Implementation of the Internal Audit Strengthening Work Plan 2006, which has been approved by the Government, can help eliminate such deficiencies

## **Accounting, Recording and Reporting**

### ***Indicator 22 (PI-22): Timeliness and regularity of accounts reconciliation***

*Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants—this is an important part of internal control and a foundation for good quality information for management and external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability. Two critical types of reconciliation are (i) reconciliation of accounting data, held in the government's books, with government bank account data held by central and commercial banks, in such a way that no material differences are left unexplained; and (ii) clearing and reconciliation of suspense accounts and advances i.e. cash payments made, from which no expenditures have yet been recorded. Advances would include travel advances and operational imprests, but not budgeted transfers to autonomous agencies and sub-national governments which are classified as expenditures when they are affected, even if reporting on any earmarked portion of the transfers is expected periodically.*

#### **Dimensions to be assessed (Scoring Method M2):**

- (i) Regularity of bank reconciliations.
- (ii) Regularity of reconciliation and clearance of suspense accounts and advances.

#### **Rating I-22: C+**

#### **Explanation of Score**

- (i) Bank reconciliation for all Treasury-managed bank accounts take place at least monthly, usually within 4 weeks from end of month. (B)
- (ii) Reconciliation and clearance of suspense accounts and advances take place annually in general—within two months of end of year, but a significant number of accounts have uncleared balances brought forward. (C)

#### **Justification for Score**

The FAR 1999 requires each operating level unit to submit the financial statements, supported with the bank reconciliation statement and details of outstanding advances to the concerned DTCO and the line department within seven days after completion of each month. The DTCO, besides monitoring the monthly financial statements from each operating unit/office, is also required to ensure that the financial statements contain correct information with regard to budget allocation, allotment and virement made thereof, the expenditures to date and balance thereof together with the bank account, and then send copies to FCGO and the line department. In addition, DTCO submits the consolidated monthly statements of allotments, revenue collection, deposits and expenditures.

Bank reconciliation of all Treasury-managed bank accounts of the expenditure budget and deposits are timely and are prepared each month, within a week from the end of the month as stipulated in the FAR. The outstanding amount of the expenditure budget bank accounts is identified and reasons are provided. There are some inherent difficulties in receiving bank statements because of reliance on the manual system and insufficient staffing. However, a shortfall in the reconciliation processes is the reconciliation of bank accounts on revenue collection, which is done once a year after the end of the fiscal year. The revenue is not accounted for bank deposit vouchers not submitted to the respective Government office. This had caused problems in reconciliation of revenue accounts. There is a huge outstanding amount of bank reconciliation in the revenue account. The Government introduced a new system of revenue deposit and accounting in 2002. This requires revenue to be deposited specifying the account code number, bank account number, name and code number of the Government office, purpose of deposit and details of the depositor.

Suspense accounts (where items are temporarily held pending final disposition) are not maintained in Government accounting—such items are mostly defined in the regulations. The regulations have a provision for offices to settle advances within 21 days from the date of receipt of the statement along with bills and vouchers. If the budget is not sufficient for settling an advance, amount payable is to be ascertained by verifying the bills and vouchers received and the amount payable after settlement has to be recorded in the statement of outstanding payments. Similarly, the regulations have a provision which states that the Office In-charge has to give an advance to the contractor only against a bank guarantee and such an advance has to be deducted from each running bill at the percentage mentioned in the contract agreement. Advances should not be given to anyone for the purpose of preventing the budget from being frozen because of non-completion of the work by the end of year. Similarly, the regulations have provisions to clear the advances as per contract terms especially for transactions related to letter of credit, mobilization transactions and ration transactions. The current practice is to carry forward unsettled advances of previous year to the new fiscal year with remarks in a column in the Bank Cash Book. It is not properly treated as cash balance from previous year.

Daily and travel allowance advances have to be cleared within 35 days from the date of return from travel while procurement advances have to be settled within seven days from the date of purchase. Similarly, letter of credit advances have to be cleared within 30 days from the receipt of the goods. Interest at the rate of 10% is charged if an advance is not cleared within the prescribed period. Salary is withheld if advance is not cleared or statement is not submitted and departmental action is taken for advances not cleared even after the salary is withheld. Advance is collected treating it as outstanding payment to Government with interest. Advance has to be cleared by accounting for expenses within the period prescribed in the regulation on receipt of necessary documents or goods or services or completion of work.

While submitting accounts of the last month of every fiscal year, the responsible person has to submit a statement of the advances outstanding of that fiscal year, the advance outstanding of the previous year and that which remains to be settled, description of the advances of which time-limit for settlement has expired and of which time-limit not expired, as well as detailed records and reasons thereof to the concerned department or ministry. Upon receipt of the statement of advances, the concerned department or ministry has to record the advances and take action against those who do not settle advances or cause them to be settled. The Office In-charge may extend the period of advance settlement for a maximum period of 21 days on receipt of an application for extension with reasonable reason. Only the department or ministry can make an extension in cases where the time limit has to be extended for a period beyond 21 days.

#### ***Indicator 23 (PI-23): Availability of information on resources received by service delivery units***

*Problems frequently arise in front-line service delivery units providing services at the community level (such as schools and health clinics) in obtaining resources that were intended for their use, whether in terms of cash transfers, distribution of materials in kind (e.g. drugs and school books) or provision of centrally recruited and paid personnel. The intended resource provision may not be explicit in budget documentation but is likely to form part of line ministries internal budget estimates preparation. Front-line service delivery units, being furthest in the resource allocation chain, may be the ones to suffer most when overall resources fall short of budget estimates, or when higher level organizational units decide to re-direct resources to other (e.g. administrative) purposes. There may be significant delays in transfer of resources to the unit whether in cash or in kind. Tracking of such information is crucial in order to determine if the PFM systems effectively support front-line service delivery.*

*Information about the receipt of resources by service units is often lacking. The accounting system, if sufficiently extensive, reliable and timely, should provide this information, but frequently information on expenditures in the field is incomplete and unreliable and the flow of information disrupted by different and unconnected systems being used at different levels of government (most primary service delivery units typically being the responsibility of sub-national governments).*

*Routine data collection systems, other than accounting systems (i.e. statistical systems), may exist and may be able to capture the relevant information along with other services delivery information. Public Expenditure Tracking Surveys, inspections, audits (whether by internal or external auditors) or other ad hoc assessments may constitute alternative information sources.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focusing on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units.

**Rating I-23: C**

**Explanation of Score**

- (i) Special surveys undertaken within the last three years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country or by primary service delivery units at local community level in several other sectors. (C)

**Justification for Score**

All public spending in the central Government is subject to the budget, which is expressed in appropriations and authorized through the allotment process under the responsibility of MOF. For the core budget, there is good information on what resources are received by DDCs. This does indicate that funds are being used for the intended purposes and that, by and large, the budget is made available to the authorities under the appropriations.

While reporting on actual uses of funds is available and reliable, the supply of funds to front-line service units is undermined by problems with the allotment procedure. In few programs such as, rural water supply and poverty alleviation programs, the Government has introduced some innovative measures to ensure that resources reach the front-line service units. Information on the receipt of resources by service units (at the facility or district level) is often lacking. Front-line service units (e.g. primary schools or health posts) have little or no information on resources allocated to them (beyond salaries of employees). FCGO, with assistance from one of the development partners, carried out a small public expenditure tracking survey in the education and health sectors. But, such surveys are not built into the system. Also, communities do not have access to information on budget implementation outside of the aggregated reporting available in Government publications.

With respect to the external budget, no verified information is provided by Government on the extent to which reported disbursements are reaching the beneficiaries. There is no record of these expenditures in Government accounting and donor reporting on expenditures is not regulated, monitored or aggregated for management of external reporting. The Auditor General does not have access to the external audit reports on the performance of service delivery contractors financed by the investment operations of the external budget.

There is reasonably a good system to track cash releases and to obtain statements thereof on time. For service delivery sectors such as education and health, the information is compiled into reports annually by the concerned ministries. Routine data collection or accounting systems provide reliable information of cash received from the front-line service delivery units (primary schools and health posts). Resources provided in kind are accounted as budget received and then spent irrespective of goods actually used. Expenditure tracking system was used once to find out the use of resources

provided in kind but there is no system to monitor the actual resources provided, spent during the period and the closing balance.

#### ***Indicator 24 (PI-24): Quality and timeliness of in-year budget reports***

*The ability to “bring in” the budget requires timely and regular information on actual budget performance to be available both to the MOF (and Cabinet) to monitoring performance and, if necessary, to identify new actions to get the budget back on track; and to the MDAs, for managing the affairs for which they are accountable. The indicator focuses on the ability to produce comprehensive reports from the accounting system on all aspects of the budget (i.e. flash reports on release of funds to MDAs are not sufficient). Coverage of expenditure at both the commitment and payment stage is important for monitoring of budget implementation and utilization of funds released. Accounting for expenditure made from transfers to de-concentrated units within central government (such as provincial administrations) should be included.*

*The division of responsibility between MOF and line ministries in the preparation of reports will depend on the type of accounting and payments system in operation. The role of MOF may be simply to consolidate reports provided by line ministries (and where applicable, from de-concentrated units) from their accounting records; in other cases the MOF may undertake the data entry and accounting for transactions in which case the role of the line ministries is reduced—perhaps—to reconciling MOF data with their own records; in yet other cases, MOF can generate reports out of integrated, computerized accounting systems. The important requirement is that data is sufficiently accurate to be of real use to all parties.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Scope of reports in terms of coverage and compatibility with budget estimates.
- (ii) Timeliness of the issue of reports.
- (iii) Quality of information.

#### **Rating I-24: C +**

#### **Explanation of Score**

- (i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both). (C)
- (ii) Reports are prepared quarterly or more frequently and issued within four weeks of end of period. (A)
- (iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports but this does not fundamentally undermine their basic usefulness. (C)

#### **Justification for Score**

The Government maintains accounts on the basis of actual expenditures. There is no system of accounting on the basis of commitment. The FAR requires submission of monthly and trimester expenditure statements showing amount of budget approved, budget released, expenditures incurred and balance. This reporting system provides actual financial information for evaluating the financial budget performance but it lacks evaluation of budget performance in quantity and quality. The Financial Procedure Act and FAR have clearly defined the responsibilities of MOF and the line ministries in the preparation of reports. Overall, FCGO, which reports to MOF, is responsible to prepare financial statements of cash release and expenditures incurred, and consolidated financial statements incorporating cash, direct payment and commodity loan or assistance. The line ministry is responsible to maintain the central accounts of all resources received and spent in cash and kind.

Financial statements from districts are obtained on line through a computerized network between FCGO and 57 out of 75 DTCOs. This has enabled FCGO to prepare financial statements relatively on a timely basis. FCGO collects financial information from the remaining 18 DTCOs manually (including copying data on to floppy disks, faxing information or delivering hard-copy statements).

The ability to monitor the budget requires timely and regular information on actual performance available to MOF (and Cabinet) for monitoring performance and, if necessary, identifying actions to get the budget back on track. Line ministries need this information to manage activities for which they are accountable. The role of MOF/FCGO is both to effect payment and maintain the primary budget execution records. The line ministry is responsible to maintain the central accounts of all resources received and spent in cash and kind, and is also responsible for reconciling FCGO data with their own records. There is no formal system of recording the accounts of commodity grants and turnkey projects which causes difficulties in reconciling information. Initiatives are underway to achieve effective two-way flow of information between FCGO and line ministries.

#### ***Indicator 25 (PI-25): Quality and timeliness of annual financial statements***

*Consolidated year-end financial statement (for French heritage countries: “le loi de reglement” supported by “les comptes de gestion” or; CGAF) are critical for transparency in the PFM system. To be complete they must be based on details for all ministries, independent departments and de-concentrated units. In addition, the ability to prepare year-end financial statements in a timely fashion is a key indicator of how well the accounting system is operating and the quality of records maintained. In some systems, individual ministries, departments and de-concentrated units issue financial statements that are subsequently consolidated by the MOF. In more centralized systems, all information for the statements is held by the MOF. Validation of the financial statements through certification by external auditor is covered in indicator PI-26. Submissions of annual financial statements from AGAs that are part of the central Government are covered in indicator PI-9.*

*In order to be useful and to contribute to transparency, financial statements must be understandable to the reader and deal with transactions, assets and liabilities in a transparent and consistent manner. This is the purpose of financial reporting standards. Some countries have their own public sector financial reporting standards set by government or an other authorized body. To be generally acceptable, such national standards are usually aligned with international standards such as the International Federation of Accounts’ International Public Sector Accounting Standards (IPSAS), of which some are relevant for countries that adopt accrual based accounting, while others are relevant for cash-based systems.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Completeness of the financial statements.
- (ii) Timeliness of submission of the financial statements.
- (iii) Accounting standards used.

#### **Rating I-25: C+**

#### **Explanation of Score**

- (i) A consolidated Government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete but the omissions are not significant. (C)
- (ii) The statement is submitted for external audit within six months of the end of the fiscal year. (A)
- (iii) Statements are presented in consistent format over time with some disclosure of accounting standards. (C)

## **Justification for Score**

GON accounts have been maintained on a cash basis of accounting since 1962 but not in line with International Public Sector Accounting Standards (IPSAS). The accounts of the local autonomous bodies, VDCs and DDCs are maintained on the cash basis while municipalities can maintain accounts either on the cash or accrual basis. Expenditures are accounted on the basis of actual cash disbursements while revenue is accounted on the basis of bank deposit slips received by the Government offices. However, the amount of revenue is presented in the financial statements on the basis of the total amount deposited in the revenue account of the central or commercial banks. Advance payments are treated as expenditures in the cash basis of accounting and assets and liabilities are neither accounted nor disclosed in the consolidated financial statements. There is no national Public Sector Accounting Standard. The financial statements are being prepared by each Government office and are submitted to the line ministry through the department. The line ministry prepares the financial statements and submits them to FCGO, which prepares the consolidated financial statements of the Government. The audited, consolidated financial statements and annual revenue and expenditure statements do not include accounting policies and explanatory notes as required by IPSAS; whereas the consolidated financial statements issued by FCGO for Government use include basic accounting principles and assumptions. The financial statements prepared by the line ministry, FCGO and OAG do not reconcile since the current accounting system does not allow recording non-cash transactions (direct payments and commodity grant or aid or turnkey projects) due to which FCGO faces difficulties in providing a true and fair picture of all such transactions in the Government's financial statements.

Rule 133 of the FAR requires FCGO to maintain central accounts of cash, direct payment and commodity loan or assistance and to prepare consolidated yearly financial statement and submit it to the OAG by the last day of the month of Poush i.e. six months from the end of the fiscal year (that is, by January 12 or 13). FCGO has been judiciously following this deadline and the consolidated annual financial statements are always submitted within the given timeframe.

## **External Scrutiny and Audit**

### ***Indicator 26 (PI-26): Scope, nature and follow-up of external audit***

*A high quality external audit is essential for creating transparency in the use of public funds. Key elements of the quality of external audit comprise the scope/coverage of the audit, adherence to appropriate standards including independence of the external audit institution (INTOSAI and IFAC/IAASB), focus on significant and systemic PFM issues in its reports, performance of the full range of financial audit such as reliability of financial statement, regularity of transactions and functioning of internal control and procurement systems. Inclusion of some aspects of performance audit (such as value for money in major infrastructure contracts) would also be also expected of a high quality audit.*

*The scope of audit mandate should include extra-budgetary funds and autonomous agencies. The latter may not always be audited by the SAI as the use of other audit institutions may be foreseen. The scope indicates the entities and sources of funds that they are audited in any given year. Where SAI capacity is limited, the audit program may be planned by the SAI in line with legal audit obligations on a multi-year basis in order to ensure that most important or risk prone entities and functions are covered annually, whereas other entities and functions may be covered less frequently.*

*While the exact process will depend to some degree on the system of government, in general the executive (the individual audited entities and/or MOF) would be expected to follow up of the audit findings through correction of errors and of system weaknesses identified by the auditors. Evidence of effective follow up of the audit findings includes the issuance by the executive or audited entity of a formal written response to the findings indicating how these will be or already have been addressed. The following year's external audit report may provide evidence of implementation by*

*summing up the extent to which the audited entities have cleared audit queries and implemented audit recommendations.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Scope/nature of audit performed (including adherence to auditing standards).
- (ii) Timeliness of submission of audit reports to legislature.
- (iii) Evidence of follow up on audit recommendations.

**Rating I-26: D+**

**Explanation of Score**

- (i) Central Government entities representing at least 75% of total expenditures are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues. (B)
- (ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors). (D)
- (iii) A formal response is made, though delayed or not very thorough, but there is little evidence of any follow-up. (C )

**Justification for Score**

The Interim Constitution 2007 establishes OAG. It authorizes the Auditor General to audit and certify accounts of Government offices, constitutional bodies, Nepal Army, Nepal Police, Supreme Court and lower courts, corporate bodies fully owned by GON and other public organizations that are required to be audited. The Audit Act 1991 specifies that the Auditor General—with due regard to regularity, economy, efficiency, effectiveness and propriety—shall audit a specified set of matters. The Audit Act does not specify conducting specialized audits, such as environment and forensic audit.

Scope of audit includes extra-budgetary funds and autonomous agencies owned by Government. The OAG follows auditing standards that are based on INTOSAI standards. The OAG is an independent constitutional body and conducts financial audits to assess reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems and performance audit of some of the entities to evaluate their overall performance as required by the Interim Constitution, Audit Act and other laws. The Auditor General focuses on significant and systematic financial and management issues in the audit report. The audited entity has to submit a formal response to the findings. The Auditor General then submits the report to the Prime Minister who sends it to the Speaker of the parliament for discussion.

OAG developed Government Auditing Standards in 1996 based on the INTOSAI auditing standards. The Government Auditing Standards were updated in 2005 in line with the revised INTOSAI auditing standards. However, the standards are still too general and do not describe the audit procedures in detail. International Standards on auditing and Nepal Standards on Auditing are not mandatory for conducting Government audit. The Nepal Standards on Auditing were developed in accordance with International Standards.

OAG adopted the INTOSAI Code of Ethics in 1996 and incorporated provisions of various laws while developing its own INTOSAI-based Code of Ethics for staff in 1999. OAG needs to revisit its Code of Ethics to ensure that it is practical and realistic for setting up a more rigorous monitoring system to ensure compliance. Since new guidelines were prepared only in 2005, considerable efforts would be required to institutionalize the practice as suggested by the guidelines through frequent

updates of training toolkits, regular orientation on guidelines and new developments, regular updating of information and research on latest developments in INTOSAI auditing standards, and regular monitoring of compliance. Further, OAG is also required to emphasize on performance audit to measure progress against envisaged outputs and outcomes.

The Auditor General conducts annual audits of all Government offices and autonomous bodies owned by GON as required by the Interim Constitution, Audit Act. The audit covers more than 95% of total expenditures of Government offices and more than 90% of the corporate bodies, development committees, other organizations and DDCs. Financial and performance audits are conducted with due consideration given to regularity, economy, efficiency, effectiveness and the propriety thereof adhering the Government auditing standards focusing on significant and systematic issues. Although audits are primarily based on transaction audits, OAG is gradually shifting focus towards a systems based approach.

Neither the Interim Constitution nor the audit law specifies the period within which the audit report is to be submitted to the legislature. The track record suggests that audit reports are generally submitted to the legislature after 12 months of the end of the period covered (it was submitted within 12 months only once). Between 2001 and 2005 when executive power was held by the King and parliament remained “dissolved”, audit reports were not submitted to the legislature or made public.

Follow-up on audit recommendations was generally weak owing partly to the political instability of the recent past. There is no established mechanism or system to follow-up on audit recommendations. As result, issues raised by the Auditor General are repeated in subsequent reports with little evidence of progress. Although the law requires a formal response to be submitted by the audited entity within 35 days from the receipt of the draft report, this rarely happens.

#### ***Indicator 27 (PI-27): Legislative scrutiny of the annual budget law***

*The power to give the government authority to spend rests with the legislature and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Assessing the legislative scrutiny and debate of annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate, and the time allowed for that process.*

*Adequacy of the budget documentation made available to the legislature is covered by PI-6.*

*In-year budget amendments constitute a common feature of annual budget processes. In order not to undermine the significance of the original budget, the authorization of amendments that can be done by the executive must be clearly defined, including limits on extent to which the expenditure budgets may be expanded and re-allocated and time limits for the executives presentation of amendments for retroactive approval by the legislature. These rules must also be adhered to.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Scope of the legislature’s scrutiny.
- (ii) Extent to which legislature’s procedures are well-established and respected.
- (iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposal on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).
- (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.

## **Rating I-27: D+**

### **Explanation of Score**

- (i) The legislature's review covers details of expenditure and revenue but only at a stage where detailed proposals have been finalized. (C)
- (ii) Procedures for the legislature's review are non-existent or not respected. (D)
- (iii) The time allowed for the legislature's review is clearly insufficient for a meaningful debate (significantly less than one month). (D)
- (iv) Clear rules exist for in-year budget amendments by the executive and are usually respected, but they allow extensive administrative reallocations. (B)

### **Justification for Score**

The MOF is responsible for preparing the budget on the basis of programs and policies approved by the NPC. The annual programs to be included in the annual budget are forwarded by the District Council in which parliamentarians representing that district are ex-officio members. The NPC discusses the programs and policies with respective parliament committees. The Finance Minister submits the annual budget to parliament on behalf of the Government. The parliament approves the bill after deliberations on the budget tabled by the Finance Minister and authorizes the Government to spend on approved programs within the limits of the budget. Before passing the annual budget, it is forwarded to the Finance Committee of parliament for detail scrutiny and recommendations. The Finance Committee examines the budget allocated for various programs on the basis of priorities and submits its report, with recommendations, to parliament. The house then debates the program and budget allocated. Amendments constitute a common feature of the annual budget processes. The supplementary budget is prepared and taken to parliament just like the annual budget as required by the Interim Constitution. The FAR clearly defines the limits of expenditure budgets that can be transferred within the sub-budget and expenditure heads.

Nepal's parliament remained dissolved since May 2002 owing to the political instability. It was a setback in the development of a good system for discussing budget proposals. Further, the legislature's budget review procedures were not respected during the years of political turmoil. Parliamentarians are ex-officio members of the District Council and play important roles in prioritizing and approving programs for the coming year. The DDCs incorporate programs approved by the District Council in their annual budgets and submit them to the concerned departments, who send it to the ministries. The ministries send their programs to the NPC. The NPC discusses the programs and policies with the concerned ministries and committees in the parliament before budget preparation. Similarly, MOF discusses the expenditure budget for approved programs with the ministries.

Although the legislature reviews government policies on the basis of which the annual budget has been prepared, Nepal has no system requiring the executive for presenting separate annual fiscal policy, medium-term fiscal framework and medium-term priorities for discussion by parliament. As such the legislature does a detail review of only expenditure and revenue.

The legislature's procedures for budget review are well established by the law. There are various review committees in parliament that examine the annual budget and submit recommendations to the house. Parliamentary committees became active after the restoration of parliament in early 2006 (Since January 2007 Nepal has an Interim Parliament). Recommendations submitted by the parliamentary committees are accepted after deliberation and the budget is revised accordingly, if necessary.

There is, however, no provision in the system for involving the legislature during the expenditure budget preparation cycle and it has no role in reviewing budget proposals. With respect to rules for in-year budget amendments without ex-ante approval by the legislature, the Finance Procedure Act has clearly defined the conditions under which the executive can amend the budget; it also specifies the limits on extent and nature of the amendments. The Secretary and the Head of the Department have authority for virement of 25% of the approved expenditure from one line item to another without affecting the approved programs. These rules are usually respected but at times audit reports also report extensive administrative reallocations.

***Indicator 28 (PI-28): Legislative scrutiny of external audit reports***

*The legislature has a key role in exercising scrutiny over the execution of the budget that is approved. A common way in which this is done is through a legislative committee(s) or commission(s), that examines the external audit reports and questions responsible parties about the findings of the reports. The operation of the committee(s) will depend on adequate financial and technical resources and on adequate time being allocated to keep up-to-date on reviewing audit reports. The committee may also recommend actions and sanctions to be implemented by the executive, in addition to adopting the recommendations made by the external auditors (ref. PI-26).*

*The focus in this indicator is on central government entities, including autonomous agencies, to the extent that either (a) they are required by law to submit audit reports to the legislative or (b) their parent or controlling ministry/department must answer questions and take action on behalf of the agencies behalf.*

*Timeliness of the legislature's scrutiny can be affected by a surge in audit report submissions, where external auditors are catching up on a backlog. In such situations, the committee(s) may decide to give first priority to audit reports covering the most recent reporting period and audited entities that have a history of poor compliance. The assessment should favorably consider such elements of good practice and not be based on the resulting delay in scrutinizing reports covering more distant periods.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).
- (ii) Extent of hearings on key findings undertaken by the legislature.
- (iii) Issuance of recommended actions by the legislature and implementation by the executive.

**Rating I-28: D+**

**Explanation of Score**

- (i) Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (D)
- (ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with MOF officials only. (C)
- (iii) Actions are recommended but are rarely acted upon by the executive. (C)

## **Justification for Score**

There is an enormous backlog in hearings on audit objections at the PAC. After the dissolution of parliament there was no arrangement for public scrutiny of the Auditor General's reports. PAC remained dissolved for almost four years (2002 to 2005) and it was reconstituted after the restoration of parliament in 2006 (and continued under the Interim Parliament in 2007). Since its reconstitution PAC has begun to play an active role in instigating public debate on outstanding irregularities reported by the annual audit reports, and in reiterating the need for financial discipline for effective public financial management. Owing to the four-year gap, there would obviously be a need for major institutional strengthening of the PAC and this should include providing exposure to committee members to best practice examples in other countries. Under a democratic system, the PAC needs to be made more effective and capable of completing hearings on audit reports within the period specified by parliament. The concerned ministry should form a separate cell to resolve audit irregularities in coordination with the audited unit, FCGO and OAG.

PAC used to be one of the most active parliamentary committees before the dissolution of the House of Representatives in 2002. When it was active, it used to review the audit reports and take decisions within 3 to 6 months. It has attempted to re-build the momentum of its hearing after 2006 but has yet to catch up with backlogs resulting from the four year "recess".

The non-existence of PAC for more than four years derailed the system of public scrutiny and corrective actions. While the PAC has always been one of the most active parliamentary committees, there is a need to develop its institutional capacity for monitoring execution of its recommendations. There is no means of tracking if actions recommended by it four years ago have been acted upon by the executive. Monitoring and follow-up on its recommended actions resumed after the restoration of the House of Representatives and formation of Interim Legislative Parliament.

## D. DONOR PRACTICES

### **Indicators of Donor Practices**

The PFM performance measurement framework includes three indicators reflecting donor practices, measuring (i) predictability of direct budget support, (ii) financial information provided by donors for budgeting and reporting on project and program aid, and (iii) the proportion of aid managed under national procedures.

#### ***Indicator One (D-1): Predictability of direct budget support***

*Direct budget support constitutes an important source of revenue for central government in many countries. Poor predictability of inflows of budget support affects the government's fiscal management in much the same way as the impact of external shocks on domestic revenue collection. Both the shortfalls in the total amount of budget support and the delays in the in-year distribution of the in-flows can have serious implications for the government's ability to implement its budget as planned.*

*Direct budget support consists of all aid provided to the government treasury in support of the government's budget at large (general budget support) or for specific sectors. When received by the government's treasury, the funds will be used in accordance with the procedures applying to all other general revenue. Direct budget support may be channeled through separate or joint donor holding accounts before being released to the treasury.*

*The narrative should explain possible reasons for the observed deviation between forecasts and actual disbursements, which could include non-implementation or delay of actions agreed with the government as condition for disbursement.*

#### **Dimensions to be assessed (Scoring Method M1):**

- (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).
- (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates).

#### **Rating D-1: D**

#### **Explanation of Score**

- (i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% or no comprehensive and timely forecast for the year(s) was provided by the donor agencies. (D)
- (ii) The requirements for Score C (or higher) are not met. (D)

#### **Justification for Score**

Direct budget support has consisted of aid from bilateral donors (from Japan Debt Relief Fund and Non-Project Grant, India and China), program loans/general budget support operations (from the Asian Development Bank and the World Bank) and sector-wide program support (from the World Bank, Denmark, Finland, DFID, Norway and the Asian Development Bank). It should be noted that this rating does not pertain to the amount of budget support provided, its share of total external assistance or adequacy in relation to national external funding requirements. Instead it rates whether budget support provided occurred in a predictable manner.

The Government has failed to secure comprehensive and timely forecasts of the amount of budget support from donors except for Japan, Debt Relief Fund and Non-Project Grant. Further, in at least two of the last three years (FY2002/03 – FY2004/05), direct budget support fell short of the forecast by more than 15%. Poor predictability of budget support inflows has affected the predictability of funds. The reasons assigned for poor predictability are (a) political uncertainty and security threats, (b) GON's inability to comply with reform commitments leading to setbacks in reform initiatives, (c) low implementation capacity, a result of the fluid political situation and insurgency, and (d) donors not complying with their commitments for budget support thus eroding credibility of budget—and by extension the Government. Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks before the government submits its budget proposals to the legislature (or equivalent approving body during political crisis) was non-existent. In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates) is very low and does not meet the criteria mentioned in rating.

***Indicator Two (D-2): Financial information provided by donors for budgeting and reporting on project and program aid***

*Predictability of disbursement of donor support for projects and programs (below referred to only as projects) affects the implementation of specific budget line items. Project support can be delivered in a wide range of ways, with varying degrees of government involvement in planning and management of resources. A lower degree of government involvement leads to problems in budgeting the resources (including presentation in the budget documents for legislative approval) and in reporting of actual disbursement and use of funds (which will be entirely the donor's responsibility where aid is provided in-kind). While the government through its spending units should be able to budget and report on aid transferred in cash (often as extra-budgetary funding or through separate bank accounts). The government is dependent on donors for budget estimates and reporting on implementation for aid in-kind. Donor reports on cash disbursements are also important for reconciliation between donor records and government project accounts.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Completeness and timeliness of budget estimates by donors for project support.
- (ii) Frequency and coverage of reporting by donors on actual donor flows for project support.

**Rating D-2: D**

**Explanation of Score**

- (i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start. (D)
- (ii) Donors do not provide quarterly reports within two months of the end of quarter on disbursements made for at least 50% of the externally-financed project estimates in the budget. (D)

**Justification for Score**

Foreign aid is channeled through the Foreign Aid Coordination Division of MOF. In principle, all foreign loan assistance is within the purview of the budget. Foreign grant assistance, to a large extent, does not fall under the purview of the budget and is mostly provided directly by donors to concerned line ministries or agencies. In case of loan assistance, donors provide information to MOF. But, in case of grant assistance, except for a very small proportion of aid that is channeled through the Government budget, there is basically no system to track how much of grant aid is flowing outside the budget. A rough estimate of Official Development Assistance (ODA) received in Nepal from 1975 to 2003 reveals that for every dollar channeled through the budget, around 1.3 dollars operates outside the system. There is no mechanism at MOF to track financial information

provided by donors. When financial information is required MOF has to obtain information from concerned line agencies. Monitoring of foreign aid flow (both within the budgetary framework and outside) is a major challenge to the system. Some of the key issues are (i) absence of data on expenditures made directly by donors (most donors only focus on disbursements from their own account to the implementing agency), (ii) absence of standard formats for reporting for grant-financed projects, (iii) concerns about the accuracy and consistency of expenditure data (in case of budget information it is monitored), and (iv) delays in providing information to the Government on grant assistance that operates outside the budgetary framework (lag time of six months for direct payments). All major donors, primarily bilateral, do not provide forecasts for disbursement of project aid for coming fiscal year and at least three months prior to its start. With regard to reporting, except for a few loan-financing donors, most do not provide quarterly reports within two months of the end-of-quarter on the disbursements made for at least 50% of the externally-financed project estimates in the budget.

**Indicator Three (D-3): Proportion of aid that is managed by use of national procedures.**

*National systems for management of funds are those established in the general legislation (and related regulations) and implemented by the mainstream line management functions of the Government. The requirement that national authorities use different (donor-specific) procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. Conversely, the use of national systems by donors can help to focus efforts on strengthening and complying with the national procedures also for domestically funded operations.*

*The use of national procedures mean that the banking, authorization, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for Government funds. All direct and un-earmarked budget support (general or sector based) will by definition use national procedures in all respects. Other types of donor funding such as earmarked budget support, basket funds and discrete project funding may use some or no elements of national procedures.*

**Dimensions to be assessed (Scoring Method M1):**

- (i) Overall proportion of aid funds to central Government that are managed through national procedures.

**Rating D-3: D**

**Explanation of Score**

- (i) Less than 50% of aid funds to central Government are managed through national procedures. (D)

**Justification for Score**

Of the total public spending of NRs.112 billion in FY2005/06, NRs.23.2 billion (about 21%) was donor financed. Of the total spending in FY2005/06, about 79% of total public spending was Government financed. The trend has been similar for several years, except in FY2003/04, when the percentage of donor-financed expenditure was about 25% and that was due to the first budget support provided by the World Bank. The Auditor General's annual reports of 2004 and 2005 have reported that a large amount of grant financing remains outside the Government's budgetary framework. They also reported the absence of reliable statistics to capture the volume of aid flowing outside the budgetary framework. The Interim Constitution requires all types of assistance to be obtained by the Government to be included in the budget and the Financial Procedure Act, 1998 requires bringing all types of assistance inside the budgetary framework and central income-

expenditure account. But the Auditor General's reports specify that there is lack of transparency in foreign grant aid as they are not within the budgetary framework and are not audited as part of national accounts. As result, there is no system for tracking the total aid in-flows.

The requirement that national authorities use different procedures for managing aid funds diverts capacity away from the national systems. This is compounded when different donors have different requirements. Since a large proportion of grant aid funds are provided directly by donors, the aid has to be managed in accordance with different donor procedures. The requirement of government staff to adapt to various donor requirements has been one of the root causes hindering capacity building of the national system. Conversely, the use of national systems by donors can help to focus efforts on strengthening national procedures. Two sector-wide programs, in the education and health sectors, are fully aligned with the country system, and through these there have been efforts to build national capacity in overall financial management. A few donors have begun to focus in aligning with the national system to help the country improve its capacity. Harmonization of procedures and building national capacity can eventually help the country to effectively improve foreign aid management. There would be a remarkable fiscal impact if all donors support this and change their behavior by aligning with the national system, and provide aid through budgetary framework. It would also improve transparency on foreign aid receipts and use. Using national procedures would mean the budgeting, accounting, banking, authorization, procurement, disbursement, reporting and auditing arrangements are the same as those used for Government funds. Although firm data are not available, based on practice and broad estimates, the general impression is that less than 50% of aid funds to Government are managed though national procedures.



### **III. SUSTAINING AND STRENGTHENING PFM PERFORMANCE: A ROADMAP**

Nepal's ratings against the PFM performance indicators indicate a public sector where financial resources are, by and large, being used for their intended purposes as authorized by a budget which is processed with transparency and has contributed to aggregate fiscal discipline. The effectiveness of Nepal's PFM systems has contributed to three major achievements. First, Nepal has maintained fiscal and macroeconomic stability. This is no small achievement considering the tumultuous political history, a protracted conflict and several economic shocks. This owes to the robustness of some of the systems in place—including the MTEF established in 2002 and a system of performance-based fund releases. Second, expenditures have gradually become more aligned to sound sector strategies. This is particularly evident in education and health, sectors in which the positive outcome has been rewarded and facilitated by donors partnering around Sector-Wide Approaches (SWAs). The realignment of expenditure programs with the 10<sup>th</sup> Plan, combined with sound sector policies, underpins some of the progress made toward the Millennium Development Goals (MDGs). Third, some key features of a reasonable, well-designed PFM system that is expected to enable good management, control, governance and accountability are in place. The PEFA assessment reveals a system that is well-designed but unevenly implemented. In particular, the budget has become a credible policy tool that is clearly linked to outcomes and policies in some sectors, with a solid control of aggregates and a reasonable control framework at the transaction level (notably for payroll). Similarly, the Public Procurement Act and amendments in the anti-corruption laws to allow bidders to report acts of corruption and allow imposition of harsher penalties providing the foundation for creating a public procurement system that is comparable with international standards.

Generally, Nepal has an advanced set of laws, regulations, and processes. But the PFM practices still indicate gaps in the control framework, significant implementation constraints and large fiscal activities that remain outside the scope of the Government budget. The perception of an inefficient, if not corrupt, system persists. Continuously refining the laws and regulations, upgrading management systems and training government employees are important parts of the agenda. Past reviews of PFM performance have focused on these issues. Nevertheless, it is important to stress that Nepal already has a very elaborate set of laws and regulations that are by and large sound. It has also made effective innovations in several areas, such as the way the MTEF was piloted and rolled out; the large number of management information systems are operating; and, the large cadre of professional employees in Government who, with a lot of good intentions, are making the system work.

The review of PFM performance revealed a good formal system with poor implementation pointing towards the need for adopting a holistic and prioritized approach because, in the past, (i) formal systems improved but informal practices did not change much, and (ii) some parts of the system were upgraded (MTEF), while others were not (physical monitoring not captured in FMIS).

Improving PFM performance therefore requires a holistic and realistic approach through the development of a well-sequenced sector strategy. A promising option is adopting a platform approach. The idea is to make consistent progress across all PFM dimensions to reach the intended outcome, which then becomes the platform for moving to the next level of reforms. These platforms, and their focus on clearly identified outcomes, will help in focusing reforms and in aligning the objectives of various activities and stakeholders.

Potential platforms, each with its targeted outcome, are identified to illustrate this approach. These platforms seek to highlight the approach and need to be further discussed and refined:

- **Platform 1: A credible budget that delivers predictable funds to frontline units and basic information for democratic accountability.** Most of the basics for this platform are in place, including innovations such as MTEF, Form No. 2, the Project Management Administrative System (PMAS), and the Public Procurement Act. A number of simple changes could be introduced to make it work: increase technical verification, increase demand for reporting (in budget preparation and budget implementation) and introduce procurement planning as mandated by the Public Procurement Act. Similarly, at the local level, efforts should be made to improve the quality of reporting (through better support from the Government). At the same time, a PFM sector-wide approach should be developed as preparation for subsequent platforms.
- **Platform 2: “Evidence-based” public finance management and streamlined control processes.** First, some changes of the first platform should be implemented (e.g. the Procurement Act). Second, systems should be reviewed to reduce fragmentation, which will help clarify accountability and improve budget implementation. This would involve a clarification of roles and responsibilities at the local level. Finally, further progress should be made in using monitoring, reporting and evaluation to manage budgets based on evidence (this is likely to entail a redesign of the budget preparation process). At the same time, some design work should be undertaken for the subsequent phase, especially for a Financial Management Information System (FMIS), local level PFM and the internal audit function.
- **Platform 3: Stronger management and accountability tools.** In the third stage, systems would be put in place to enable a deepening of the focus on performance. This would likely include rolling out of the FMIS to provide more timely and high-quality information; reforming internal audit to create a feedback loop for managers and enhancing local-level PFM. These efforts would provide the information basis for deepening the MTEF and strengthening external accountability (e.g. by focusing more on systemic issues as opposed to irregularities). Parallel improvements in public administration would be necessary to enable the move to the next platform.
- **Platform 4: Deepen performance-based orientation.** Tentatively, this fourth approach would involve a further shift toward performance-based budgeting. This assumes that the earlier platforms have delivered the necessary environment (in public administration management, information systems, evaluation capacity, etc.). This is the stage where initial efforts toward accrual accounting could be made.

This is a medium-term agenda which would have the following management implications. Although the first platform has almost been reached, each platform would take two to three years to attain. Therefore it is a 10-year activity plan. Sustaining such an effort requires dedicated stakeholders and coordinated plans. Hence the first platform would include the definition of a PFM sector strategy, which would be used as a tool for reform coordination (including coordination of donor support). The PEFA framework could serve as the monitoring framework. MOF is the obvious agency to lead such an effort. However, a broader constituency needs to be created, which could include (i) internally, the team of secretaries whose interest in PFM performance should be nurtured, and whose demand for good physical and financial information should be developed and met; and (ii) externally, a team of selected parliamentarians, interested donors and possibly, the media, academic personalities and civil society leaders.

A parallel priority would be improving public oversight over the budget and its outcome. Important elements are in place, such as the Auditor General and the PAC. However, more needs to be done to hold policymakers accountable, both on the supply side (more informative budget documents, user friendly within-year and end-of-year budget reports) and on the demand side (at the national, local and community levels).

GON is committed to have a vision for improving public financial management that will have a broader development impact, with a wide range of actions required for strengthening the existing functions and capacities and for moving forward towards building a New Nepal with a modern and effective financial management system. The ratings of this assessment provide a baseline for improving the performance of the PFM system and monitoring the progress. The nature of the indicators and the deficiencies highlighted by the ratings means that measurable progress, in terms of improved ratings, is likely to occur over several years rather than in the short-run. GON is committed to form a permanent Steering Committee to keep track of progress of various reform actions outlined in the Road Map to ensure satisfactory results for pushing the scores at least one step up from the level during the assessment.

A stakeholder workshop was organized to finalize the DAP on February 13, 2008. The Auditor General, the two finance secretaries, the Financial Comptroller General, secretaries of various line ministries, senior government officials and representatives of Nepal's development partners attended the workshop. The meeting discussed and agreed on the following modality for implementing the DAP:

- Create a permanent Steering Committee and PEFA secretariat.
- Own, lead and monitor implementation of DAP actions by the heads of respective ministries, departments and agencies.
- Coordinate with development partners for mobilizing technical and financial support for implementing DAP.
- Develop a detailed implementation strategy and modality.
- Update the PFM benchmarks every two years.

Annex-4 provides a summary of the PFM assessment and a roadmap for implementation in the short-and medium-terms. It seeks to ensure that all areas of PFM are covered. High-level of attention would be required to ensure effective implementation of the Road Map for taking Nepal towards good governance and for establishing a government that is accountable. Implementation of actions proposed in the Road Map need to be prioritized using the platform approach.

The roadmap highlights a few critical cross-cutting issues:

- ***Enhancing the ownership of all actions by responsible agencies is critical to improve PFM performance.*** The first PFM assessment was carried out with full ownership of the Government and involvement of a large number of stakeholders. The Government needs to continue this effort for placing the PFM agenda as a development priority. Development outcomes can be achieved only if there is accountability in the use of resources. The implementation of the Road Map needs to be monitored by the parliament and also the Cabinet. Improved PFM performance will ensure effective implementation of development programs, thus contributing to the overarching goal of poverty reduction.
- ***The success of the reform program will also depend on the sustained partnership of development partners.*** Implementation of the PFM program needs to be approached in an incremental basis, adopting the platform approach. This requires technical and financial support from development partners. PFM in a sector-wide approach is the right intervention for generating equitable improvements in all dimensions. The government seeks support from development partners for creating a multi-donor trust fund to implement the action plan contained in the Road Map for PFM improvement.

The next steps for effective implementation of the action plan would include the following: (1) prioritize actions around a set of mutually supportive measures that are feasible, realistic and sustainable, and can generate a step change in PFM performance each year; (2) develop support for these reforms (among staff of MOF, Government and its agencies, parliament, ordinary citizens aspiring for a New Nepal and with the international community), (3) reinforce the policy agenda with a sound organizational and institutional development plan, (4) prepare a detailed Financial Management Improvement Program with support from a multi-donor trust fund with a clear assessment of technical assistance requirements in a holistic manner, and (5) develop a process to monitor actions and performance, review progress and fine tune the program as required.

**Table A1.1: Deviation of Actual Expenditures from Budgeted Expenditures**

	in NRs. 000s		
	<u>2003/04</u>	<u>2004/05</u>	<u>2005/06</u>
Total Budget Estimate	102,400,000	111,689,900	126,885,100
Less			
1 Interest/Debt Estimate	17,551,116	20,112,898	21,217,121
2 Direct Payment Estimate	12,769,993	12,437,299	13,713,290
3 Donor Cash Estimate	15,563,007	19,872,601	19,505,210
Total	45,884,116	52,422,798	54,435,621
Net Budget Estimate	56,515,884	59,267,102	72,449,479
Actual			
Total Expenditures	89,442,593	102,560,471	110,889,158
Less			
1 Interest/Debt Payment	17,338,738	19,751,330	20,423,476
2 Direct Payment	8,544,007	11,361,223	9,687,098
3 Donor Cash Expenditures	10,368,387	12,296,077	12,354,706
Total	36,251,132	43,408,630	42,465,280
Net Budget Expenditures	53,191,461	59,151,841	68,423,878
%	94.12	99.81	94.44
Difference	5.88	0.19	5.56

**Table A1.2: Variance in Expenditure Composition 2003/04**

	Budget (2003/04)	Actual (2003/04)	Difference	Absolute Difference	%
Revenue & Financial Administration	9,259,268	7,235,000	2,024,268	2,024,268	21.9%
Industry, Commerce & Supplies	571,562	532,761	38,801	38,801	6.8%
Law, Justice & Parliamentary Affairs	26,433	24,154	2,279	2,279	8.6%
Agriculture & Cooperatives	1,502,313	1,371,394	130,919	130,919	8.7%
Home Affairs	7,053,671	7,387,741	-334,070	334,070	4.7%
Water Resources	1,105,660	1,053,597	52,063	52,063	4.7%
Physical Planning & Works	2,679,476	2,195,305	484,171	484,171	18.1%
Culture, Tourism & Civil Aviation	293,085	311,624	-18,539	18,539	6.3%
Foreign Affairs	1,019,194	850,334	168,860	168,860	16.6%
Land Reform & Management	612,830	570,373	42,457	42,457	6.9%
Women, Children & Social Welfare	205,053	189,044	16,009	16,009	7.8%
Defense	7,184,221	8,524,765	-1,340,544	1,340,544	18.7%
Forestry & Soil Conservation	1,641,234	1,479,170	162,064	162,064	9.9%
Environment, Science & Technology	231,230	221,846	9,384	9,384	4.1%
Education & Sports	12,384,956	12,051,090	333,866	333,866	2.7%
Information & Communication	970,376	905,769	64,607	64,607	6.7%
Local Development	2,857,858	2,578,700	279,158	279,158	9.8%
Health & Population	3,594,795	3,423,710	171,085	171,085	4.8%
Labor & Transport Management	110,489	119,072	-8,583	8,583	7.8%
Investments – Public Enterprises	824,300	613,934	210,366	210,366	25.5%
Others	2,387,880	1,552,077	835,803	847,581	35.5%
	56,515,884	53,191,460	3,324,424	6,739,674	11.9%
Total Expenditures	56,515,884	53,191,460	-3,324,424	3,324,424	5.9%
Composition Variance	56,515,884	53,191,460		6,739,674	11.9%

**Table A1.3: Variance in Expenditure Composition 2004/05**

	Budget (2004/05)	Actual (2004/05)	Difference	Absolute Difference	%
Revenue & Financial Administration	8,525,656	6,487,291	2,038,365	2,038,365	23.9%
Industry, Commerce & Supplies	600,535	566,040	34,495	34,495	5.7%
Law, Justice & Parliamentary Affairs	25,813	23,610	2,203	2,203	8.5%
Agriculture & Cooperatives	1,502,618	1,455,200	47,418	47,418	3.2%
Home Affairs	7,618,703	8,525,066	-906,363	906,363	11.9%
Water Resources	1,136,597	962,101	174,496	174,496	15.4%
Physical Planning & Works	2,551,687	2,260,406	291,281	291,281	11.4%
Culture, Tourism & Civil Aviation	332,820	364,254	-31,434	31,434	9.4%
Foreign Affairs	1,048,762	952,675	96,087	96,087	9.2%
Land Reform & Management	707,174	682,501	24,673	24,673	3.5%
Women, Children & Social Welfare	233,193	212,330	20,863	20,863	8.9%
Defense	8,005,396	10,998,158	-2,992,762	2,992,762	37.4%
Forestry & Soil Conservation	1,588,971	1,547,215	41,756	41,756	2.6%
Environment, Science & Technology	227,145	211,809	15,336	15,336	6.8%
Education & Sports	12,621,577	12,654,113	-32,536	32,536	0.3%
Information & Communication	1,087,329	1,060,904	26,425	26,425	2.4%
Local Development	3,707,302	3,468,276	239,026	239,026	6.4%
Health & Population	3,812,103	3,570,306	241,797	241,797	6.3%
Labor & Transport Management	175,930	160,418	15,512	15,512	8.8%
Investments – Public Enterprises	1,340,863	1,294,835	46,028	46,028	3.4%
Others	2,416,928	1,694,327	722,601	768,149	31.8%
	59,267,102	59,151,835	115,267	8,087,005	13.6%
Total Expenditure	59,267,102	59,151,835	115,267	115,267	0.2%
Composition Variance	59,267,102	59,151,835		7,318,856	12.3%

**Table A1.4: Variance in Expenditure Composition 2005/06**

	Budget (2005/06)	Actual (2005/06)	Difference	Absolute Difference	
Revenue & Financial Administration	1,0370,098	6,158,425	4,211,673	4,211,673	40.6%
Industry, Commerce & Supplies	788,688	639,285	149,403	149,403	18.9%
Law, Justice & Parliamentary Affairs	29,201	25,677	3,524	3,524	12.1%
Agriculture & Cooperatives	2,060,968	1,843,085	217,883	217,883	10.6%
Home Affairs	8,895,179	9,407,663	-512,484	512,484	5.8%
Water Resources	1,732,157	1,534,964	197,193	197,193	11.4%
Physical Planning & Works	3,601,116	3,113,217	487,899	487,899	13.5%
Culture, Tourism & Civil Aviation	465,990	435,402	30,588	30,588	6.6%
Foreign Affairs	1,055,039	911,329	143,710	143,710	13.6%
Land Reform & Management	762,397	697,092	65,305	65,305	8.6%
Women, Children & Social Welfare	281,506	234,780	46,726	46,726	16.6%
Defense	10,905,847	11,746,123	-840,276	840,276	7.7%
Forestry & Soil Conservation	1,710,043	1,677,323	32,720	32,720	1.9%
Environment, Science & Technology	323,572	270,438	53,134	53,134	16.4%
Education & Sports	15,466,302	14,836,770	629,532	629,532	4.1%
General Administration	68,676	80,358	-11,682	11,682	17.0%
Information & Communication	1,160,480	1,143,924	16,556	16,556	1.4%
Local Development	4,612,803	4,381,774	231,029	231,029	5.0%
Health & Population	4,340,212	3,848,995	491,217	491,217	11.3%
Labor & Transport Management	173,087	164,155	8,932	8,932	5.2%
Investments – Public Enterprises	1,180,322	3,219,322	-2,039,000	2,039,000	172.7%
Others	2,465,796	2,053,767	412,029	412,029	16.7%
	72,449,479	68,423,868	4,025,611	10,832,495	15.0%
Total Expenditures	72,449,479	68,423,868	4,025,611	4,025,611	5.6%
Composition Variance	72,449,479	68,423,868		10,420,466	14.4%

### **Economic and Administrative Classifications**

Economic Code	Economic Classification
<b>Current</b>	
0	His Majesty & Royal Family
1.01	Salary
1.02	Allowances
1.03	Transfer Travelling Allowance
1.04	Clothing
1.05	Food
1.06	Employee Medical Expenses
1.07	Retirement Benefit
1.08	Staff Training
11.01	Interest Repayment – Domestic
11.02	Interest Repayment – Foreign
12.01	Refund Expenditure
2.01	Water and Electricity
2.02	Communication
2.03	General Office Expenses
2.04	Rent
2.05	Repair and Maintenance
2.06	Fuel and Oil
2.07	Consultancy and Other Services fee
2.08	Miscellaneous
3.01	Operating Subsidy – Public Enterprise
3.02	Local Government – Unconditional Grant
3.03	Non-profit Institutions – Unconditional Grant
3.04	Subsidy Social Security
3.05	Non-profit Institutions – Conditional Grant
3.06	Local Government – Conditional Grant
3.07	Scholarship
4.01	Production Materials
4.02	Medicines
4.03	Books and Materials
4.04	Program Supplies and Expenses
4.05	Program Travelling Expenses
4.06	Operation and Maintenance of Public Property
9.01	Contingencies – Current
<b>Capital</b>	
5.01	Land Acquisition
5.02	Building Purchase
6.01	Furniture
6.02	Vehicles
6.03	Machinery and Equipment
6.04	Building Construction
6.05	Civil Construction
6.06	Capital Formation
6.07	Research and Consultancy Services Fee
7.01	Investment – Share
7.02	Investment – Loan
8.01	Capital Grants to Public Enterprises

Economic Code	Economic Classification
8.02	Local Government – Unconditional Grant
8.03	Non-profit Institutions – Unconditional Grant
8.05	Non Profit Institutions – Conditional Grant
8.06	Local Government – Conditional Grant
9.02	Contingencies – Development
10.01	Principal Repayment – Domestic
10.02	Principal Repayment – Foreign

Function Code	Functional classification
11	His Majesty and Royal Family
12	State Council
13	National Assembly
14	Courts
15	Commission for the Prevention of Abuse of Authority
16	Office of the Auditor General
17	Public Service Commission
18	Election Commission
19	Office of the Attorney General
20	Council of Justice
21	National Human Rights Commission
27	National Vigilance Centre
30	Prime Minister and Council of Ministers' Office
35	Ministry of Finance
38	Ministry of Industry Commerce and Supplies
39	Ministry of Law, Justice and Parliamentary Affairs
40	Ministry of Agriculture and Cooperatives
45	Ministry of Home
47	Ministry of Water Resources
48	Ministry of Physical Planning and Works
49	Ministry of Culture, Tourism and Civil Aviation
50	Ministry of Foreign Affairs
55	Ministry of Land Reform and Management
56	Ministry of Women, Children and Social Welfare
58	Ministry of Defense
59	Ministry of Forestry and Soil Conservation
61	Ministry of Environment, Science and Technology
62	Ministry of Peace and Reconstruction
65	Ministry of Education and Sports
66	Ministry of General Administration
67	Ministry of Information and Communication
69	Ministry of Local Development
70	Ministry of Health and Population
71	Ministry of Labor and Transport Management
72	National Planning Commission
81	Ministry of Finance – Repayment of Domestic Debt
82	Ministry of Finance – Repayment of Foreign Debt: Multilateral
83	Ministry of Finance – Repayment of Foreign Debt: Bilateral
87	Ministry of Finance – Investments - Public Enterprises
90	Ministry of Finance – Retirement Facilities and Staff Facilities
95	Ministry of Finance – Miscellaneous

<b>Budget Preparation, Responsible Institutions and Timeline</b>			
Serial No.	Activities	Responsible Institution	Time Period
1	Estimation of next fiscal year's budget including preliminary report for each ministry. Estimation of expenditure for each ministry and fixation of resource ceiling.	NPC/MOF/Line ministry	Between December 15 to first week of January
2	Issue Budget Formulation Guidelines with budget ceiling to sectoral ministry, department and agencies.	NPC/MOF/Line ministry	Within January
3	Submission of three-year budget estimate to MOF.	Consolidated estimate of ministry, departments and agencies by line ministry	Within March
4	Discussion over the estimated budget submitted.	NPC in association with MOF and line ministry	Between May and June
5	Presentation, discussion and approval of budget.	MOF, Cabinet and Parliament	Between second week of July to second week of September
6	Budget implementation including advance bill approval, authorization letter for implementation.	MOF and line ministry	Between second and third week of July
7	Budget implementation (capital expenditures): authorization letter and approved program.	NPC/MOF/Line ministry	Within 15 days of the Parliament approval
8	Budget Release : <ol style="list-style-type: none"> <li>1. Imprest Fund for recurrent and capital expenditure.</li> <li>2. Budget release and replenishment of Imprest Fund after the issuance of authorization of capital expenditure.</li> </ol>	DTCO  Ministries, departments and agencies/FCGO/DTCO	Third week of July (first week of new fiscal year)  As demanded
9	Revision of the program after mid-term evaluation of the budget.	NPC/MOF/Line ministry	Between January 15 and February 15 as required



**DEVELOPMENT ACTION PLAN FOR STRENGTHENING  
PUBLIC FINANCIAL MANAGEMENT (PFM) PERFORMANCE  
SHORT- AND MEDIUM- TERM ACTION PLAN**

PFM Area	PFM Indicators	PFM Benchmark (As of 2005/06) Assessment				Action Plan		Measuring Progress and Benefits
		Dimensions to be Assessed	Score	Explanation of Score	Key Issues	Actions	Responsible Agency	
<b>A: PFM OUT-TURNS</b>								
A. Credibility of the Budget (PI-1 to PI-4)	PI-1: Aggregate expenditure outturn compared to original approved budget.	The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure).	B	<ul style="list-style-type: none"> <li>In no more than out of one of the last three years has the actual expenditure deviated by an amount equivalent to more than 10% of budgeted expenditure.</li> </ul>	Deviation of actual expenditure from budgeted expenditure was more than 1% in FY2004/05, more than 5% in another year and over 10% in one year.	<b>Short-Term (&lt; 18 months)</b> <ul style="list-style-type: none"> <li>Monitor actual expenditures periodically to ensure that there is no variance more than 5% of budgeted expenditures.</li> <li>Strengthen the monitoring system to evaluate progress of revenue collecting offices.</li> <li>Implement “reward and punishment” policy, incentive schemes pegged to performance indicators for high achievers and initiate action against non-achievers</li> <li>Strengthen the institutional capacity of large taxpayer office</li> <li>Assess the scope for broadening the tax base</li> </ul>	MOF, NPC	Improved utilization of budgeted expenditures.
	PI-2: Composition of expenditure outturn compared to original approved budget.	Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years.	C	<ul style="list-style-type: none"> <li>Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.</li> </ul>	Appropriation Act and FAR restrict the magnitude of virement across sectors, intra sectors, budget lines; and, within budget lines, economic heads.		MOF, NPC, FCGO	Improved budgeting procedure by sector. Incentive structure linked with performance is in place
	PI-3: Aggregate of revenue outturn compared to the original approved budget.	Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.	A	<ul style="list-style-type: none"> <li>Actual domestic collection was below 97% of budgeted domestic revenue estimates no more than one of the last three years.</li> </ul>	Challenge to streamline various areas of taxes.		MOF and concerned Departments	Monitoring indicators, evaluation weights developed/ upgraded
							MOF, FCGO, OAG, Accounting Standards Board	Evaluation by supervising authority every 3 months

PFM Area	PFM Indicators	PFM Benchmark (As of 2005/06) Assessment				Action Plan		Measuring Progress and Benefits
		Dimensions to be Assessed	Score	Explanation of Score	Key Issues	Actions	Responsible Agency	
A. Credibility of the Budget (PI-1 to PI-4)	<b>PI-4:</b> Stock and monitoring of expenditure payment arrears.	<ul style="list-style-type: none"> <li>Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.</li> <li>Availability of data for monitoring the stock of expenditure payment arrears.</li> </ul>	D+	<ul style="list-style-type: none"> <li>The Stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has reduced significantly in the last two years. (C )</li> <li>There is no reliable data on the stock of arrears from the last two years.(D)</li> </ul>	<p>The system is weak in tracking and recording of stocks.</p> <p>The system of arrears recording is weak and partial.</p> <p>Since the accounting system is cash based, there is no system to account the liabilities.</p>	<ul style="list-style-type: none"> <li>Strengthen and expand the system for comprehensive monitoring of non-filers, tax dodgers</li> <li>Develop and implement appropriate public sector accounting and reporting system</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Develop methodology for sector-wise budget allocation, parameter for making sectoral estimation and monitoring indicators.</li> <li>Develop appropriate public sector accounting and auditing standards.</li> <li>Develop revenue forecasting system for setting collection targets at all levels</li> <li>Establish a system to initiate survey of stock of arrears on annual basis at year-end in order to monitor the stock of expenditure payment arrears.</li> <li>Strengthen the system of stock recording and reporting in line with financial reporting system.</li> </ul>		<p>Incentives scheme with performance indicators in place (at least 4 new offices added each year)</p> <p>Underlying principles of revenue forecast published as part of budget documentation</p> <p>Sector and office wise revenue forecasting models in place</p>

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<b>B: KEY CROSS CUTTING ISSUES.</b>								
B. Comprehensiveness and Transparency (PI-5 to PI-10)	<b>PI.5. Classification of the budget.</b>	The classification system used for formulation, execution and reporting of the central Government's budget.	C	<ul style="list-style-type: none"> <li>The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.</li> </ul>	<p>The move towards full GFS system has not fully evolved as per the need and capacity.</p> <p>The current classification and chart of accounts follow GFS coding formats and standards on the flow side but not the stock.</p> <p>No orientation is provided to the staff of MOF, FCGO and NPC about GFS/COFOG with regard to budget classification, execution and reporting.</p> <p>Different coding system is applied in local government.</p> <p>There is no clarity in the policy on use and implementation of extra-budgetary funds.</p>	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Review Immediate Action Plan (IAP) process and make it consistent with budget process.</li> <li>Make budget document more user-friendly.</li> <li>Move focus of budget to programmatic approach.</li> <li>Develop a system for reports on achievements, ex-post reviews of MTEFs, sectoral expenditure programs, etc. and ensure budget is based on such information</li> <li>Provide ex-ante comprehensive budget (or plan), including central and local governments, State owned enterprises (SOEs), revolving funds.</li> <li>Clarify policy on use and implementation of extra-budgetary funds</li> </ul>	MOF, NPC, FCGO, MOLD	Up-gradation of budget classification system.  GFS/COFOG-based Budget document.  IAP in Budget document.  Use of budget document information in media.  Number of sectors structured around programs.  Report from MOF to parliament on how such evidence was used.  Clear policy on extra-budgetary funds.

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B. Comprehensiveness and Transparency (PI-5 to PI-10)	<b>PI-6.</b> Comprehensiveness of information included in budget documentation.	Share of the listed information in the budget documentation most recently issued by the Government (in order to count in the assessment, the full specification of the information benchmark must be met).	B	<ul style="list-style-type: none"> <li>Recent budget documentation fulfils 5-6 of the 9 information benchmarks.</li> </ul>	<p>Debt stock reconciliations, including details at least for the beginning of the current year, not complete.</p> <p>No practice of maintaining financial assets, including details at least for the beginning of fiscal year.</p> <p>Deficit, describing anticipated composition is not in place. Deficit financing decomposed at aggregate level.</p> <p>Reconciled, verified and updated data of investment not prepared on time, and not specified in budget speech.</p>	<p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Review budget classification system to upgrade the classification based on administrative, economic and functional classifications, using GFS/COFOG standard, and develop appropriate training program for wider dissemination.</li> <li>Develop a plan to separate institutional responsibilities of MOF, NPC and line ministries for budgeting and planning.</li> <li>Enhance integration of external assistance in budget.</li> <li>Develop a policy framework to capture the fiscal information incurred at local government level to be consistent with central Government fiscal reporting.</li> <li>Enhance accounting capacity of local government bodies (VDCs, DDCs, and Municipalities) and public enterprises so that these agencies will be able to submit fiscal reports including audited accounts to central Government at least annually.</li> </ul>	MOF, NPC, FCGO, MOLD	<p>Improved budget classification system based on administrative, economic and functional classification, using GFS/COFOG standards.</p> <p>Comprehensive financial information discussed in parliament</p>

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B. Comprehensiveness and Transparency (PI-5 to PI-10)	PI-7. Extent of un-reported government operations.	<ul style="list-style-type: none"> <li>The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported i.e. not included in fiscal reports.</li> <li>Income/expenditure information on donor-funded projects which is included in fiscal reports.</li> </ul>	C	<ul style="list-style-type: none"> <li>The level of unreported extra-budgetary expenditure (other than donor-funded projects) constitutes 5-10% of total expenditure. (C)</li> <li>Complete income/expenditure information for all loan-financed projects is included in fiscal reports. (C )</li> </ul>	<p>Lack of legal and institutional arrangements to capture extra-budgetary resources and expenditures incurred by national para-statal institutions, and transparent reporting thereof.</p> <p>Some grant-funded projects are not reflected in the budget. How do we address the issue that for every \$1 spent through the budget, there is \$1.3 spent outside the budget?</p> <p>Off budget donor-funded activities are not under the purview of statutory financial reporting by FCGO and of audit by OAG.</p>	<p><b><u>Medium Term( &gt;18 Months)</u></b></p> <ul style="list-style-type: none"> <li>Formulate and implement the legal structure to capture the resources and expenditures incurred by national para-statal institutions.</li> <li>Develop mechanism to bring unreported extra-budgetary expenditure in the regular budgetary system.</li> <li>Update and Implement Foreign Aid Policy to include all donor funded projects within the budget purview.</li> </ul>	MOF, NPC, OAG	Use of public funds made transparent in the government financial statements.

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B. Comprehensiveness and Transparency (PI-5 to PI-10)	<b>PI-8.</b> Transparency of inter-governmental fiscal relations.	<ul style="list-style-type: none"> <li>Transparent and rules based system in the horizontal allocation among sub-national (SN) governments of unconditional and conditional transfers from central government (both budgeted and actual allocations);</li> <li>Timeliness of reliable information to SN governments on their allocations from central government for coming year;</li> <li>Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.</li> </ul>	C	<ul style="list-style-type: none"> <li>The horizontal allocation of only a small part of transfers from central government (10-50%) is determined by transparent and rules based systems. (C )</li> <li>Reliable information to SN governments is issued before the start of the SN fiscal year, but too late for significant budget changes to be made. (C )</li> <li>Fiscal information (at least ex-post) that is consistent with central Government fiscal reporting is collected for at the least 60 % (by value) of SN government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year. (C )</li> </ul>	<p>With less than 10% of total local government expenditure from their own resources, much of their annual plan funding is dictated by central Government's tied fund transfer.</p> <p>Transparency and accountability of allocated funds are not rolled out in local governments.</p> <p>Performance-based funding system not initiated in all local governments.</p> <p>Lack of predictable fiscal year ceiling, including conditional and unconditional grants to local government including District Development Committees (DDCs).</p> <p>Lack of statutory harmonized mechanism for classification of revenue, expenditure and consolidated local bodies accounting and financial reporting system.</p> <p>Insufficient use of ICT in PFM in local bodies.</p> <p>Absence of inclusion of LSGA financial statements in Budget Speech.</p>	<b>Medium Term( &gt;18 Months)</b> <ul style="list-style-type: none"> <li>Upgrade formulae-based mechanism to allocate block grants to all local government bodies.</li> <li>Develop a transparent and accountable system for allocation of funds in all local government bodies.</li> <li>Devise a mechanism to channel the conditional, unconditional and ad-hoc grants through local governments.</li> <li>Develop clear devolution strategy to operationalize the spirit of LSGA.</li> <li>Develop procedures for the allocation of centrally-collected local development funds along with budget ceilings on the principles of contribution and necessity.</li> <li>Amend LSGA and Financial Procedure Act for consistency with the Transparency Act.</li> <li>Develop LSGA Accounting and Reporting System based on GFS.</li> <li>Develop a parameter for budget ceiling allocation in the central department level</li> </ul>	MOLD, MOF, FCGO, Local self-government bodies	<p>Budget allocation through formal accounting centers of local government bodies.</p> <p>Allocated funds in all local government bodies to be made transparent.</p> <p>Budget Speech to incorporate both central and local level budget.</p> <p>Enactment of integrated Fiscal Transparency Act.</p> <p>Inclusion of extra-budgetary expenditures into the budgetary framework.</p> <p>Local government fiscal information is consistent with central Government fiscal reporting.</p>

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B. Comprehensiveness and Transparency (PI-5 to PI-10)	PI-9. Oversight of aggregate fiscal risk from other public sector entities.	<ul style="list-style-type: none"> <li>Extent of central Government monitoring of autonomous government agencies (AGAs) and Public Enterprises (PEs).</li> <li>Extent of central Government monitoring of sub-national governments' fiscal position.</li> </ul>	D+	<ul style="list-style-type: none"> <li>Most AGAs/PEs submit fiscal reports to central governments, at least, annually, but a consolidated overview is missing or significantly incomplete. (C )</li> <li>No annual monitoring of sub-national governments' fiscal position takes place or it is significantly incomplete. (D)</li> </ul>	<p>Monitoring and follow-up actions of audit observations by the central Government is weak.</p> <p>There is presence of un-funded quasi-fiscal activities of loss making PE; the extent of this stock is unknown in any given year.</p> <p>Consolidated overview of net fiscal position is weak to the extent of non-capture of local government's expenditures.</p> <p>Accounting standards of PE and their registration are not uniform. There is a lack of a clear policy on PE in terms of ownership, autonomy, investment and accountability. Investment records are difficult to reconcile.</p>	<b>Medium Term( &gt;18 Months)</b> <ul style="list-style-type: none"> <li>Replace the manual accounting and reporting system with computer-based system to significantly reduce the time lag for preparing financial statements.</li> <li>Reduce the payment centers from the current 3,500 to a reasonable number.</li> <li>Amend the policy to submit year-end financial statements within 6 months</li> <li>Make it compulsory to submit financial statements to FCGO within 3 months of end of fiscal year.</li> <li>Make it a policy to publicize AG reports upon submission to parliament.</li> <li>Make all contracts with value above NRs. 6 million transparent.</li> </ul>	MOF FCGO OAG	<p>Overall consolidation of fiscal risk by the central Government.</p> <p>Timely preparation of financial statements.</p> <p>Year-end financial statements disclosed within 6 months</p>
	PI-10. Public access to key fiscal information.	<ul style="list-style-type: none"> <li>Number of the listed elements under this indicator of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met).</li> </ul>	B	<ul style="list-style-type: none"> <li>The Government makes available to the public 3-4 of the 6 listed types of information.</li> </ul>	<p>Year-end financial statements are made public within 12 months.</p> <p>There is a long time gap to make the Auditor General's annual reports public after the Auditor General submits them to parliament.</p> <p>Making transparent of all contracts with value above NRs. 6 million has not yet been institutionalized.</p>	<ul style="list-style-type: none"> <li>Make it compulsory to submit financial statements to FCGO within 3 months of end of fiscal year.</li> <li>Make it a policy to publicize AG reports upon submission to parliament.</li> <li>Make all contracts with value above NRs. 6 million transparent.</li> </ul>		

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B. Comprehensiveness and Transparency (PI-5 to PI-10)					<ul style="list-style-type: none"> <li>• Make National Accounting Standards mandatory at all PEs</li> <li>• Review PE and privatization policy for making PEs result oriented</li> <li>• Establish one window system for investment in PEs</li> <li>• Establish e-billing and network financial reporting</li> </ul>		

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<b>C. BUDGET CYCLE</b>								
C(i). Policy-Based Budgeting (PI-11 to PI-12)	<b>PI.11.</b> Orderliness and participation it the annual budget process.	<ul style="list-style-type: none"> <li>Existence of an adherence to a fixed budget calendar.</li> <li>Clarity/comprehensiveness of political involvement, in the guidance on the preparation of budget submissions (budget circular or equivalent).</li> <li>Timely budget approval by the legislature or similarly mandated body (within the last three years).</li> </ul>	C+	<ul style="list-style-type: none"> <li>A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows ministries, departments and agencies (MDAs) reasonable time (at least 4 weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time. (B)</li> <li>A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before they have completed their submission. (B)</li> <li>The budget has been approved with more than two months delay in row during the last three years (D )</li> </ul>	<p>Top-down approach of budget formulation process needs to be replaced by bottom-up approach so that fixed budget calendar will be more effective.</p> <p>Public participation has not been formalized in the formulation of the annual programs and budgeting.</p> <p>Frequent adjustment of program and budget presented by MDAs.</p>	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Monitor the implementation of Budget Preparation Directory and Budget Operations Manual and plan to get the budget approved by parliament before the start of the fiscal year.</li> <li>Operationalize CSDRM software for DSA by establishing training program</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Revisit the budget calendar documents in line with bottom-up approach in programming and budgeting.</li> <li>Improve the budget formulation process by actively engaging political leadership.</li> <li>Build Government capacity to carry out debt sustainability analysis (DSA) and aim to carry it out on an annual basis.</li> <li>Expand the preparation of sector strategies for important sectors, and investments based the strategies.</li> </ul>	MOF, FCGO, NPC  MOF, FCGO, NPC  MOF, FCGO  NPC, MOF  NPC, MOF	Budget is approved by the legislature before the start of the fiscal year.  Ensure ownership of budget by people's representatives  Debt sustainability analysis for external and domestic debt is undertaken on a regular basis.  Sector strategies are prepared for key sectors of the economy.  Publication of three year consolidated budget and expenditure report.  Periodic analysis of DSA in a systematic manner.

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C(i). Policy-Based Budgeting (PI-11 to PI-12)	<b>P.12.</b> Multi-year perspective in fiscal planning, expenditure policy and budgeting.	<ul style="list-style-type: none"> <li>Preparation of multi-year fiscal forecast and functional allocations.</li> <li>Scope and frequency of debt sustainability analysis (DSA).</li> <li>Existence of sector strategies with multi-year costing of recurrent and investment expenditures.</li> <li>Linkages between investment budget and forward expenditure estimates.</li> </ul>	C+	<ul style="list-style-type: none"> <li>Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained. (B)</li> <li>A DSA for at least for external debt undertaken once during last three years. (C)</li> <li>Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure OR costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts . (C)</li> <li>Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases. (C )</li> </ul>	<p>In the absence of coherent, approved sector strategies, the periodic Plan document is loosely costed although some activities are costed to the unit level.</p> <p>Linkages between sector strategies, investment budget and forward expenditure estimates are, at best, weak and questionable in meeting the policy outcomes.</p> <p>CSDRM software for DSA is in place but has not been “operationalized” due to lack of trained human resources..</p>	<ul style="list-style-type: none"> <li>Advance budget preparation process and ensure sequencing of MTEF and the annual budget (with appropriate review by political leadership; and early statement and discussion of fiscal policy objectives in parliament).</li> <li>Move gradually toward an output-based budget system and, over the longer run, a results-oriented system</li> </ul>		

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C(iii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-13.</b> Transparency of Taxpayer Obligations and Liabilities	<ul style="list-style-type: none"> <li>Clarity and comprehensiveness of tax liabilities.</li> <li>Taxpayer access to information on tax liabilities and administrative procedures.</li> <li>Existence and functioning of a tax appeals mechanism.</li> </ul>	C+	<ul style="list-style-type: none"> <li>Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary power of government entities involved. (C)</li> <li>Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due to coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date. (C)</li> <li>A tax appeals system of transparent administrative procedures is completely either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow-up on its decisions need to be addressed. (B)</li> </ul>	<p>The excise and liquor laws allow some discretionary decisions. Income Tax Act is difficult to understand.</p> <p>Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited.</p> <p>There is a system for tax appeal but, transparency, fairness and effectiveness are questionable when tax arbitration is slow and can take more than a year for resolution resulting into substantial financial cost.</p> <p>Existing Tax Appeal System is not effective.</p>	<b>Short-Term (&lt; 18 months)</b> <ul style="list-style-type: none"> <li>Make penalties in excise and liquor act consistent and reduce discretionary powers</li> <li>Implement new customs act by formulating and implementing customs regulations</li> <li>Develop simplified guidelines on Income Tax Act and program for educating taxpayers</li> <li>Develop software to provide taxpayer access to personal data through electronic means.</li> <li>Provide taxpayer's registration status and filing/non-filing information by SMS</li> <li>Complete Inland Revenue Department website with regular updates of tax procedures including acts, regulations, guidelines, etc.</li> <li>Upgrade ASYCUDA system in all customs offices</li> <li>Institutionalize valuation system at all customs offices</li> <li>Open commercial bench in courts</li> <li>Strengthen and revitalize the Revenue Tribunal.</li> <li>Maintain time-bound administrative review system at IRD</li> <li>Devise a mechanism for implementing court decisions</li> </ul>	MOF, IRD, customs, courts and revenue tribunals	Excise and liquor acts revised  New customs laws implemented  Taxpayer (user) friendly Income Tax Act guidelines developed  Monthly update of IRD website  Taxpayers provided access to personal data  Commercial bench set up at courts  Integrated software for Excise, VAT and income tax is in place and functioning  IRD, customs and DRI integrated network is in place and functioning

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C(iii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-14.</b> Effective measure for taxpayer registration and tax assessment.	<ul style="list-style-type: none"> <li>Controls in the taxpayer registration system.</li> <li>Effectiveness of penalties for non-compliance with registration and declaration obligations.</li> <li>Planning and monitoring of tax audit and fraud investigation programs.</li> </ul>	C	<ul style="list-style-type: none"> <li>Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. (C)</li> <li>Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance. (C)</li> <li>There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria. (C)</li> </ul>	Except for customs, efforts are underway to link all the databases of Inland Revenue (excise, VAT and Income Tax); but, integration of these databases will take sometime.	<b>Medium-Term (&gt; 18 months)</b> <ul style="list-style-type: none"> <li>Develop and provide e-filing of returns, e-TDS and e-PAN services.</li> <li>Extend PAN registration in some sectors</li> <li>Make submission of tax statement/return mandatory for renewal of licenses</li> <li>Develop a complete integrated system of software for Income Tax, VAT and excise duty at IRD.</li> <li>Integrate database of customs, DRI and IRD</li> <li>Review and monitor audited files to improve quality in IRD</li> <li>Review risk-management criteria for audit at both IRD and customs</li> <li>Expand implementation of post-clearance audit at customs</li> </ul>	MOF, IRD DRI, FCGO, NRB, commercial banks	<p>Integrated software of revenue accounting system (MRAS) is in place in IROs, DTCOs, customs offices and banks.</p> <p>Risk management criteria for audit is in place.</p> <p>Authority is set up to collect/write-off specific arrears</p> <p>Modern revenue accounting system of software integrated with IROs, customs, DTCOs and banks.</p>
	<b>PI-15.</b> Effectiveness in collection of tax payments.	<ul style="list-style-type: none"> <li>Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).</li> <li>Effectiveness of transfer of tax collections to the Treasury by the revenue administration.</li> <li>Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.</li> </ul>	D+	<ul style="list-style-type: none"> <li>The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collection). (D)</li> <li>Revenues collections are transferred to the Treasury at least weekly. (B)</li> <li>Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay. (D)</li> </ul>	Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury take place annually but it takes more than 4 months at the end of the year for completing reconciliation.	<ul style="list-style-type: none"> <li>Remove all barriers on highways.</li> <li>Update Income Tax arrears database</li> <li>Formulate law and establish appropriate authority to collect specific arrears</li> <li>Launch revenue accounting system software at all Inland Revenue offices, major customs offices, DTCOs and banks.</li> <li>Accelerate Phase-II (2006-2009) of customs modernization</li> </ul>		

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C(ii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-16.</b> Predictability in the availability of funds for committed expenditure.	<ul style="list-style-type: none"> <li>Extent to which cash flows are forecast and monitored.</li> <li>Reliability and horizon of periodic in-year information to ministries, departments and agencies (MDAs) on ceilings for expenditure commitment.</li> <li>Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.</li> </ul>	C+	<ul style="list-style-type: none"> <li>A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated. (C)</li> <li>MDAs are provided reliable information on commitment ceilings at least quarterly in advance. (B)</li> <li>Significant in-year budget adjustments are frequent, but are undertaken with some transparency. (C )</li> </ul>	The adjustment and virement of the allocated budget are provisioned not on the basis of frequency but as per the percentage of the total budget and nature of the headings to the Office Head, Departmental Head, Secretary and MOF.	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Prepare weekly expenditure and revenue forecasts.</li> <li>Weekly monitoring of liquidity position.</li> <li>Develop External Debt Strategy.</li> <li>Introduce monthly cash-forecasting system.</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Introduce budget surrender policy and implementation system</li> <li>Refine monthly cash flow forecasts.</li> <li>Develop and implement the debt management system.</li> <li>Review internal debt policy and link with cash management.</li> <li>Link foreign debt and internal borrowing with the GDP.</li> <li>Prepare Debt and Guarantee Issuing Policy.</li> </ul>	MOF, FCGO, NRB	<p>Sound liquidity position and adherence to economic stability</p> <p>Transparent debt strategy.</p> <p>All cash balances are calculated daily and consolidated.</p> <p>Domestic and foreign debt records are complete, updated and reconciled on a monthly basis.</p>

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C(ii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-17.</b> Recording and management of cash balances and guarantees.	<ul style="list-style-type: none"> <li>Quality of debt-data recording and reporting.</li> <li>Extent of consolidation of the government's cash balances.</li> <li>Systems for contracting loans and issuance of guarantees.</li> </ul>	C+	<ul style="list-style-type: none"> <li>Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content. (C )</li> <li>Most cash balances are calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement. (B)</li> <li>Central Government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or ceilings. (C )</li> </ul>	<p>A dedicated unit at FCGO regularly updates both domestic and foreign debt. Although, the CSDRMS can facilitate debt management, debt is recorded manually owing to operational problems.</p> <p>Cash-flow forecasting system is not yet institutionalized.</p> <p>The Foreign Aid Policy 2002 restricts any form of government guarantee—the last such agreement was done 10 years ago. National Debt and Guarantee Act underpins borrowing and is amended at the beginning of the fiscal year.</p>			

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C(ii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-18.</b> Effectiveness of payroll control.	<ul style="list-style-type: none"> <li>Degree of integration and reconciliation between personnel records and payroll data.</li> <li>Timeliness of changes to personnel records and the payroll.</li> <li>Internal controls of changes to personnel records and the payroll.</li> <li>Existence of payroll audits to identify and control weakness and /or ghost workers.</li> </ul>	C+	<ul style="list-style-type: none"> <li>A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place once at least every six months. (C)</li> <li>Up to 3 months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally. (B)</li> <li>Controls exist but are not adequate to ensure full integrity of data. (C)</li> <li>A payroll audit covering all central Government entities has been conducted at least once in the last 3 years (whether in stages or as one single exercise). (B)</li> </ul>	<p>Personnel and payroll data are not directly linked yet.</p> <p>Personnel records are maintained by the Civil Personnel Office. Beside this, personnel records are maintained at ministry, where the person is working; but there are problems of reconciliation. Although there is ambiguity in the process of recording grade (increment each year for different grade rates is difficult to compute) no such anomaly exists in the scale. Scale constitutes 90% of total payroll.</p> <p>Payroll internal audits are conducted on a monthly basis by District Treasury Controller Offices (DTCOs); they are audited on an annual basis by an external auditor, the OAG. Payroll audit hardly exists, and workers are mostly paid under the civil works budget, thus creating probability of ghost workers.</p>	<b>Short-Term (&lt; 18 months)</b> <ul style="list-style-type: none"> <li>Update the personnel database regularly.</li> </ul> <b>Medium-Term (&gt; 18 months)</b> <ul style="list-style-type: none"> <li>Develop direct linkage between personnel database and payroll to ensure data consistency and monthly reconciliation.</li> </ul>	MOGA, FCGO	<p>Regular maintenance of personnel database.</p> <p>Linkage between personnel database and payroll.</p>

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C(ii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-19.</b> Competition, value for money and controls in procurement.	<ul style="list-style-type: none"> <li>Evidence on the use of open competition for award of contracts that exceeds the nationally established monetary threshold for small purchases (percentage of the number of contracts that are above the threshold).</li> <li>Justification for use of less competitive procurement methods.</li> <li>Existence and operation of a procurement complaints mechanism.</li> </ul>	C	<ul style="list-style-type: none"> <li>Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate. (C)</li> <li>Justification for use of less competitive methods is weak or missing. (C)</li> <li>A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaint. (C)</li> </ul>	<p>On procurement tracking, although the use of open competition is mandatory for procurement, there is no system to maintain data.</p> <p>Often procurement is sliced into small packages to avoid referral to higher authority for approval.</p> <p>The Public Procurement Act has a formal complaints or appeals mechanism in place. Its implementation remains to be tested.</p> <p>Lack of competition (collusion, muscle-power, external influence)</p> <p>Lack of transparency</p> <p>Inadequate attention on value for money in public expenditures</p>	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Enforce E-government procurement (E-GP) at least for bid submission and opening.</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Improve the institutional capacity of the Public Procurement Monitoring Office (PPMO) and implement the Public Procurement Act, and initiate statistical monitoring.</li> <li>Establish Review Board and formal complaints and appeals mechanism.</li> <li>Implement recommendations of E-GP assessment to enhance transparency.</li> <li>Operationalize technical, performance and public audits in large procurements</li> </ul>	PPMO, MDAs  PPMO, National Vigilance Centre, OAG, MDAs, users committees.	Number of bids increased  Institutional development of PPMO and implementation of the law. Procurement performance indicators to be defined (notably timeliness)  Complaints and appeals mechanism operationalized.  Technical, performance and public audits carried out in large procurements.

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C(ii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-20.</b> Effectiveness of internal controls for non-salary expenditures.	<ul style="list-style-type: none"> <li>Effectiveness of expenditure commitment controls.</li> <li>Comprehensiveness, relevance and understanding of other internal control rules/procedures.</li> <li>Degree of compliance with rules for processing and recording transactions.</li> </ul>	C	<ul style="list-style-type: none"> <li>Expenditure commitment control procedures exist but are partially effective, but they may not comprehensively cover all expenditures or they may be occasionally violated. (C)</li> <li>Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions; these rules are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance.(C)</li> <li>Rules are complied in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations remains an important concern. (C)</li> </ul>	<p>Although there is a good procedure for expenditure commitment control, enforcement, especially during the last trimester of the fiscal year, is violated often in the name of crisis and emergency.</p> <p>Rules are judiciously followed in all disciplines, but use of simplified/emergency procedures in unjustified situations (observed during conflict years) is an important concern.</p> <p>Other than the MTEF, there is no mechanism for controlling commitment of future liabilities.</p> <p>Proper accounting standards for recording, reporting and settlement of incurred liabilities do not exist.</p> <p>Lack of appropriate system of advance treatment has created huge volume of financial irregularities and increased public concern.</p>	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Based on Financial Procedure Regulations, 2064 (FPR), each line ministry to devise specific control systems.</li> <li>Monitor the implementation of internal control system as described in the related rules and approved programs and budget.</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Review control framework and accounting system, with a view to introducing Integrated Financial Management Information System (structured around District Accounting Systems)</li> <li>Review system of bank accounts and simplify, to the extent possible, with a view to increase quality of reconciliation of accounts.</li> <li>Clarify the nature of advances and make them grants when appropriate; enforce monitoring of advances (Form No. 14)</li> <li>Enforce system of monitoring outstanding liabilities (Form No. 18).</li> <li>Develop appropriate accounting standards to control commitment for future liabilities.</li> </ul>	OAG, FCGO	<p>Standard Operating Procedures for each line ministry developed.</p> <p>Effective budget management and expenditure controls.</p> <p>Accounts reconciled on time.</p> <p>Amount of irregularities due to advances reduced.</p> <p>Information of outstanding liabilities available in budget.</p>

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C(ii). Predictability and Control in Budget Execution (PI-13 to PI-21)	<b>PI-21.</b> Effectiveness of internal audit.	<ul style="list-style-type: none"> <li>Coverage and quality of the internal audit function.</li> <li>Frequency and distribution of report.</li> <li>Extent of management response to internal audit findings.</li> </ul>	D+	<ul style="list-style-type: none"> <li>There is little or no internal audit focused on systems monitoring. (D)</li> <li>Reports are issued regularly for most government entities, but may not be submitted to the Ministry of Finance and the Supreme Audit Institution (SAI). (C )</li> <li>Internal audit recommendations are usually ignored (with few exceptions). (D)</li> </ul>	<p>Internal audit reports are generally weak and not focused from the risk management perspective. Very little observations are made on the performance of internal control systems.</p> <p>There is no structure with regard to the professional independence of internal auditors.</p> <p>There is a conflict of interest in carrying out effective internal audit since the same accounting staffs rotate for carrying out both the accounting and internal audit functions.</p> <p>Internal auditors do not use professional audit methods or follow the risk-based approach. The scope of work under internal audit is also not properly defined. There is no Code of ethics for internal auditors. The concept of internal audit committee has not yet been introduced in the system.</p> <p>Capacity in internal audit is a major constraint that is affected by trained and skilled manpower, and inadequate motivation and incentives for carrying out meaningful internal audit.</p> <p>Capacity is even weaker in case of local government, and the internal audit system as required by local Financial Administration Regulations has not yet been institutionalized.</p>	<p><b>Short Term (&lt;18 months)</b></p> <ul style="list-style-type: none"> <li>OAG to issue forms to all audited units asking to report on the unsettled internal audit observations.</li> <li>Form audit committees in all entities at the central level to review and take actions on internal and external audit observations.</li> </ul> <p><b>Medium-Term (&gt;18 months)</b></p> <ul style="list-style-type: none"> <li>Develop vision of internal audit and develop institutional strengthening program for internal audit and address all inherent key issues (both at central and local level).</li> <li>Develop criteria for internal auditors.</li> <li>Prepare annual consolidated internal audit report to be submitted to GON and OAG.</li> </ul>	OAG, FCGO	Effective internal audit system is in place and is operationalized.

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C(iii). Accounting, Recording and Reporting (PI-22 to PI-25)	<b>PI-22.</b> Timeliness and regularity of account reconciliations.	<ul style="list-style-type: none"> <li>Regularity of bank reconciliations.</li> <li>Regularity of reconciliation and clearance of suspense accounts and advances.</li> </ul>	C+	<ul style="list-style-type: none"> <li>Bank reconciliation for all Treasury managed bank accounts take place at least monthly, usually within 4 weeks from end of month.(B)</li> <li>Reconciliation and clearance of suspense accounts and advances take place annually, within 2 months of end of year, but a significant number of accounts have uncleared balances brought forward. (C )</li> </ul>	<ul style="list-style-type: none"> <li>There are inherent difficulties in receiving bank statements because of the tradition of working with manual system and insufficient staff.</li> <li>A shortfall in the reconciliation process is the reconciliation of bank accounts of revenue collection, which is reconciled once in a year after the end of the fiscal year. There is no practice of monthly reconciliation of revenue figures generated by NRB, FCGO, individual bank branches and Treasury offices.</li> <li>Current accounting system is cash based and does not address the methodology for advance treatment and suspense account.</li> </ul>	<b>Medium-Term (&gt; 18 months)</b> <ul style="list-style-type: none"> <li>Initiate reform in accounting system moving to IPSAS cash based accounting system, and implement the recommendations of Gap Analysis.</li> <li>Adopt Nepal Public Sector Accounting Standards.</li> <li>Introduce single account treasury system for all government financial transactions.</li> <li>Reduce the number of payment centers.</li> <li>Ensure use of compatible accounting software for all government transactions.</li> </ul>	MOF FCGO NRB Commercial Banks	Transition to IPSAS cash based accounting system and capacity building  Quality of financial statement improved  Verified and reliable statement of contingent liabilities, advances and deposits.  All beneficiaries handling government transactions apply uniform software.

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C(iii), Accounting, Recording and Reporting (PI-22 to PI-25)	PI-23. Availability of information on resources received by service delivery units.	<ul style="list-style-type: none"> <li>Collection and processing of information to demonstrate resources that were actually received (in cash and kind) by the front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective to which the level of government is responsible for the operation and funding of those units.</li> </ul>	C	<ul style="list-style-type: none"> <li>Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country OR by primary service delivery units at local community level in several other sectors. (C )</li> </ul>	<p>With respect to the external budget, verified information is not provided by the Government on the extent to which reported disbursements are reaching the beneficiaries.</p> <p>There is no system of maintaining records of such expenditures in Government accounting, and donor reporting on expenditures is not regulated, monitored, or aggregated for management of external reporting.</p> <p>The Auditor General does not have access to the external audit reports on the performance of the service delivery contractors financed by the investment operations of the external budget.</p>	<ul style="list-style-type: none"> <li>Improve accounting system to include all types of resources received in cash and in kind by service delivery units with information compiled in a report on an annual basis.</li> <li>Establish one window system to overcome the challenge of overlapping the funds to service delivery units.</li> <li>Design a computerized reporting system linking financial progress with physical progress.</li> </ul>	MOF FCGO NPC NRB Commercial Banks	Information available on program and budget of service delivery units.
	PI-24. Quality and timeliness of in-year budget reports.	<ul style="list-style-type: none"> <li>Scope of reports in terms of coverage and compatibility with budget estimates.</li> <li>Timeliness of the issue of reports.</li> <li>Quality of information.</li> </ul>	C+	<ul style="list-style-type: none"> <li>Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both). (C)</li> <li>Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period. (A)</li> <li>There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not undermine their basic usefulness. (C)</li> </ul>	<p>The Government maintains accounts on the basis of actual expenditures. There is no system of accounting on the basis of commitment.</p> <p>There is no formal system of recording the accounts of commodity grants and turnkey projects, which cause difficulty in reconciling information.</p>			

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		Dimensions to be Assessed	Score	Explanation of Score	Key Issues	Actions	Responsible Agency	
C(iii). Accounting, Recording and Reporting (PI-22 to PI-25)	PI-25. Quality and timeliness of annual financial statements.	<ul style="list-style-type: none"> <li>Completeness of the financial statements.</li> <li>Timeliness of submission of the financial statements.</li> <li>Accounting standards used.</li> </ul>	C+	<ul style="list-style-type: none"> <li>A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant. (C)</li> <li>The statement is submitted for external audit within six months of the end of the fiscal year. (A)</li> <li>Statements are presented in consistent format over time with some disclosure of accounting standards. (C)</li> </ul>	<p>The assets and liabilities are neither accounted nor disclosed in the consolidated financial statements.</p> <p>There is no national Public Sector Accounting Standards.</p> <p>Advance payments are treated as expenditures in the existing cash basis of accounting.</p> <p>The audited consolidated financial statements and annual revenue and expenditure statements do not include accounting policies and explanatory notes as required by IPSAS; whereas the consolidated financial statements issued by the Financial Comptroller General Office for government use include basic accounting principles and assumptions.</p> <p>The financial statements prepared by the line Ministry, FCGO and OAG do not reconcile since the current accounting system does not allow to record non-cash transactions (direct payments and commodity grant or aid or turnkey projects) due to which FCGO is facing difficulties to provide true and fair picture of all such transactions in the government's financial statements.</p>			

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C(iv). External Scrutiny and Audit (PI-26 to PI-28)	<b>PI-26.</b> Scope, nature and follow-up of external audit.	<ul style="list-style-type: none"> <li>Scope/nature of audit performed (including adherence to auditing standards).</li> <li>Timeliness of submission of audit reports to legislature.</li> <li>Evidence of follow up on audit recommendations.</li> </ul>	D+	<ul style="list-style-type: none"> <li>Central government entities representing at least 75% of total expenditures are audited annually, covering revenue, and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues. (B)</li> <li>Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors). (D)</li> <li>A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up. (C )</li> </ul>	<p>Corporate audit coverage is limited. Bilateral/multilateral grants and technical assistance are not under parliamentary audit scrutiny.</p> <p>Follow-up on audit recommendations is generally weak due to non enforcement of existing legal provision. As a result, issues raised by the Auditor General are repeated in subsequent reports.</p> <p>Systematic follow-up of previous audit reports is not done.</p> <p>No practice of issuing entity-level final audit report with management response on the report.</p>	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Develop capacity for risk-based audit approach.</li> <li>Issue audit reports only after obtaining comments on audit observations from audited.</li> <li>Coordinate with Public Accounts Committee (PAC) for enforcing legal provisions to settle outstanding audit irregularities.</li> <li>Adapt the practice for issuing final audit report to individual audited entity to solicit their response.</li> <li>Initiate the system of feedback to the audited entities on the previous years audit observations and their actions in the current year audit report.</li> <li>Direct to full enforcement of existing legal provision to settle the audit irregularities within stipulated timeframe</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Clear audit backlog of SOEs and other extra-budgetary funds.</li> <li>Introduce the system of risk-based audit and develop capacity.</li> </ul>	OAG OAG MOF FCGO	<p>Improvements in the timeliness and quality of audit reports.</p> <p>Scrutiny of audit reports to be completed within 6 months upon submission of the report to the legislature.</p> <p>Improvements in the timeliness and quality of audit report</p>

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					<ul style="list-style-type: none"> <li>Initiate reform in auditing system addressing the current deficiencies, and implement the recommendation of Gap Analysis to make AG work program more focused on systemic issues; make its annual report focused on systemic issues; produce a user-friendly summary.</li> <li>Review adequacy and reliability of audit system.</li> <li>Introduce reporting by OAG on those entities operated with government grants.</li> <li>Specify audit reporting mandate needs in the Constitution and Audit Act.</li> <li>Provide infrastructure and resources to complete the audit by OAG within stipulated time.</li> <li>Manage to present the consolidated financial statements by FCGO within 3 months from the end of fiscal year.</li> <li>Redefine the reporting mandate of presenting annual performance report and audit report.</li> <li>Develop follow-up audit planning accompanied by an annual audit plan and issue necessary format to collect information on settlement of audit observations.</li> </ul>		

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C(iv). External Scrutiny and Audit (PI-26 to PI-28)	I-27. Legislative scrutiny of the annual budget law.	<ul style="list-style-type: none"> <li>Scope of the legislature's scrutiny.</li> <li>Extent to which the legislature's procedures are well-established and respected.</li> <li>Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposal on macro-fiscal aggregates earlier in the budget preparation cycle (in practice time is allowed for all stages combined).</li> <li>Rules for in-year amendments to the budget without ex-ante approval by the legislature.</li> </ul>	D+	<ul style="list-style-type: none"> <li>The legislature's review covers details of expenditure and revenue, but only to the extent where detailed proposals have been finalized. (C)</li> <li>Procedures for the legislature's review are non-existent or not respected. (D)</li> <li>The time allowed for the legislature's review is clearly insufficient for a meaningful debate (significantly less than one month). (D)</li> <li>Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations. (B)</li> </ul>	<p>There is no system for the Government to present separate annual fiscal policy, medium-term fiscal framework and medium-term priorities for discussion at the legislature. Currently, the legislature gives emphasis only to the detail review of expenditure and revenue.</p> <p>There is no provision in the system for the legislature to be involved in the expenditure budget preparation cycle and the parliament does not have role in reviewing budget proposals.</p> <p>Budget Formulation Guidelines do not specify the role of the legislature in budget formulation.</p>	<p><b>Short-Term (&lt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Develop support for parliament to carry out informed review of the budget.</li> </ul> <p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Prepare Budget Law.</li> </ul>	MOF Budget Committee	Improved capacity of legislature to review the budget.
	PI-28. Legislative scrutiny of external audit reports.	<ul style="list-style-type: none"> <li>Timeliness of examination of audit reports by the legislature (for reports received within the last three years).</li> <li>Extent of hearings on key findings undertaken by the legislature.</li> <li>Issuance of recommended actions by the legislature and implementation by the executive.</li> </ul>	D+	<ul style="list-style-type: none"> <li>Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (D)</li> <li>In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with MOF officials only. (C)</li> <li>Actions are recommended, but are rarely acted upon by the executive. (C)</li> </ul>	<p>There is a need for major institutional strengthening of the PAC.</p> <p>Non-existence of PAC for more than 4 years derailed the public hearing system and the implementation of recommended actions.</p> <p>PAC Operational Procedure needs to be developed.</p> <p>Follow-up actions on PAC recommendations and directives are not monitored closely.</p>	<p><b>Medium-Term (&gt; 18 months)</b></p> <ul style="list-style-type: none"> <li>Initiate institutional strengthening program of PAC, and strengthen collaboration with OAG to ensure timely examination of audit reports.</li> <li>Develop specific Operational Procedures for PAC.</li> <li>Develop a monitoring system to monitor the implementation of PAC recommendations and directives.</li> </ul>	MOF PAC OAG	Improved institutional capacity of PAC for legislative scrutiny of audit reports.  PAC proceedings.

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<b>D. DONOR PRACTICES</b>								
D. Donor Practices (D-1 to D-3)	<b>D-1.</b> Predictability of Direct Budget Support.	<ul style="list-style-type: none"> <li>Annual deviation of actual budget support from the forecast provided by the donor agencies at least 6 weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).</li> <li>In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates).</li> </ul>	D	<ul style="list-style-type: none"> <li>In at least two of the last three years did direct budget support outturn fell short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies. (D)</li> <li>The requirements for Score C (or higher) are not met. (D)</li> </ul>	<p>Poor predictability of inflows of budget support has affected the predictability of funds.</p> <p>In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates) is very low and does not meet the criteria mentioned in rating.</p>	<p><b>Short-Term (&lt;18 months)</b></p> <ul style="list-style-type: none"> <li>Revise and implement the Foreign Aid Policy.</li> <li>Develop medium-term expenditure framework to which donor financial support can respond.</li> <li>Donors to provide timely information on actual expenditures following Government definitions.</li> <li>Donors to provide information on planned disbursements early in fiscal year.</li> </ul> <p><b>Medium-Term (&gt;18 months)</b></p> <ul style="list-style-type: none"> <li>Government to regularly publish internal and external assessment of PFM performance.</li> <li>Support enhanced alignment of donor funding for priorities established by the Government's Plans.</li> </ul>	MOF Donors  MOF Donors	Improved predictability of donor assistance.  Transparent information on external assistance.  Improved budgetary support and support through SWAp by donors.  Share of aid going through the budget using national system, untied funds; disbursed in cash.

PFM Area	PFM Indicators	PFM Benchmark (As of 2005/06) Assessment			Action Plan		Measuring Progress and Benefits
		Dimensions to be Assessed	Score	Explanation of Score	Key Issues	Actions	
D. Donor Practices (D-1 to D-3)	<b>D-2.</b> Financial information provided by donors for budgeting and reporting on project and program aid.	<ul style="list-style-type: none"> <li>Completeness and timeliness of budget estimates by donors for project support.</li> <li>Frequency and coverage of reporting by donors on actual donor flows for project support.</li> </ul>	D	<ul style="list-style-type: none"> <li>All major donors do not provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least 3 months prior its start. (D)</li> <li>Donors do not provide quarterly reports within 2 month of end of quarter on the disbursements made for at least 50% of the externally- financed project estimates in the budget. (D)</li> </ul>	<p>Foreign grant assistance does not fall under the purview of the Government budget—to large extent—and is mostly funded directly by donors to the concerned line ministries or agencies, outside budget scrutiny. In case of grant assistance, except for a very small proportion of the aid that is channeled through the budget system, there is basically no system to track how much of aid grant is flowing outside of the Government budget.</p> <p>There is no system or mechanism at MOF to track financial information provided by donors.</p> <p>Monitoring of foreign aid flow (both within the budgetary framework and outside) is a major challenge to the system.</p> <p>All major donors, primarily, bilateral, do not provide budget forecast for disbursement of project aid for coming fiscal year and at least 3 months prior to its start.</p> <p>With regard to reporting, except for a few loan-financing donors, most donors do not provide quarterly reports within 2 months of end of quarter on the disbursements made for at least 50% of the externally-financed project estimates in the budget.</p>	<ul style="list-style-type: none"> <li>Donors to move further toward support through SWAp and budgetary support.</li> <li>Expand adoption of Procurement Act by donors.</li> <li>Use PFM Assessment Framework as tool to monitor progress with PFM performance</li> <li>Development of appropriate mechanism for foreign assistance</li> </ul>	<p>Donors MOF, Line Ministries/Agen cies</p>

PFM Area	PFM Indicators	PFM Benchmark (As of 2005/06) Assessment				Action Plan		Measuring Progress and Benefits
		Dimensions to be Assessed	Score	Explanation of Score	Key Issues	Actions	Responsible Agency	
D. Donor Practices (D-1 to D-3)	D-3. Proportion of aid that is managed by use of national procedures.	• Overall proportion of aid funds to central Government that are managed through national procedures.	D	• Less than 50% of aid funds to central Government are managed through national procedures. (D)	The Auditor General's annual reports of 2004 and 2005 have reported that a large sum of grant financing is out of the budgetary framework; also reported is that reliable statistics to capture the proportion of aid flowing out of the budgetary framework do not exist.  There is no system to track the total aid flow to the country.	• Channel all donor assistance through the Government's budgetary system.  • Develop a mechanism to ensure transparency of all foreign aid mobilized.	MOF	Improved ratio of donor assistance.



**PART B:**

**PUBLIC  
PROCUREMENT  
MANAGEMENT  
SYSTEM**



## **IV. PUBLIC PROCUREMENT FOR DEVELOPMENT EFFECTIVENESS<sup>4</sup>**

Past studies identified poor governance, inefficiencies in public expenditure management and weaknesses in institutional capacity as major factors preventing Nepal from attaining its full social and economic development potential. Poor financial management, including non-transparent procurement practices, perceived high levels of corruption and a decline in the quality of the civil service, resulted in low expectations of public services and contributed to the high cost of doing business. Improving governance, establishing effective public accountability and enhancing the trust of citizens are high priorities of the Government as they are instrumental in creating the conditions needed for peace and stability.

Procurement is a fundamental component of planning, spending and accounting for the use of public money. The World Bank analyzed Nepal's public procurement system in its Country Procurement Assessment Review (CPAR) of 2002. The findings formed the basis of a Government action plan for improving the system.

This section examines the extent to which the Government of Nepal (GON) has been able to establish the core components needed in a well-functioning procurement system. It is structured around the assessment of a group of indicators developed by the Organization for Economic Cooperation and Development-Development Assistance Committee (OECD-DAC) to support efforts to monitor and improve procurement functions. The assessment was carried out by a joint team comprising GON representatives and the World Bank. The findings are designed to establish a snapshot of the procurement system for providing policy makers inputs for improving procurement outcomes. The report also suggests a framework for monitoring the progress of reform and implementation.

The Public Procurement Act 2063 (2007) approved in January 2007 has changed the legal framework governing procurement. It has also modified the arrangements for managing public procurement. In view of these changes, the World Bank agreed with the GON that the assessment of the legal and managerial components of procurement would take into consideration the new Act.

### **Overview**

Significant improvements have been made in the public procurement in Nepal between 2001 and 2006. Notable advances include

- Adoption of a modern procurement law with provisions that are generally in line with the United Nations Commission for International Trade Law (UNCITRAL) model law,
- Creation of a Public Procurement Monitoring Office (PPMO) with responsibility and authority for setting policy, monitoring practices and reporting on overall system performance;
- Organization of training designed to establish core competencies in the area of procurement, and
- Amendment of anti-corruption laws to enable the imposition of harsher penalties (such as blacklisting) for acts of fraud and corruption and allowing bidders to report acts of corruption by other bidders or government officials.

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<sup>4</sup> The assessment was based on the draft of the Public Procurement Act which was enacted in January 2007.

Much work remains to be done for translating the progress in legislation into concrete improvements in procurement outcomes. Implementation of the Public Procurement Act remains a major challenge and will require the dedication of significant resources for using the law to improve public procurement practices. In addition, the Act also contains some provisions that could become problematic during implementation. One such provision is the requirement of Cabinet approval for contract variations exceeding 15% because it could result in an excessively cumbersome review process and it may need to be revisited sometime in the near future.

This assessment covers four main areas—the legal and regulatory basis for procurement, the institutional architecture of the system, the operation of the system and competitiveness of the national market, and the integrity of the system. There is significant room for improvement in each area and no one area stands out as particularly weak or strong.

### **The Assessment of Nepal’s Public Procurement System using the OECD-DAC Tool for Benchmarking and Assessing Procurement Systems**

The World Bank and OECD-DAC led an international consultative process and developed a set of tools for assessing procurement systems and supporting their improvement in 2006. The OECD-DAC Tool for Benchmarking and Assessing Procurement Systems has been used in many countries around the world. The tool, organized around 12 primary indicators, is based on key elements of a well-functioning public procurement system. It focuses on the overall procurement system and its process involves a comparative assessment of existing elements against the main baseline indicators (or standards). It enables identification of the strengths and weaknesses in the design of national systems. The tool does not measure performance by itself but does enable making qualitative judgments on the level of achievement or conformity of the system with a set of predetermined benchmarks. The 12 indicators are broken down into a set of sub-indicators that map the core elements in each area.

<b>Pillars and Indicators</b>	
<b>I. Legislative and Regulatory Framework</b>	
<b>Indicator 1:</b>	Procurement legislative and regulatory framework complies with applicable obligations deriving from national and international requirements.
<b>Indicator 2:</b>	Availability of implementing regulations, documentation and tools to support implementation of its framework.
<b>II. Institutional Framework and Management Capacity</b>	
<b>Indicator 3:</b>	The public procurement system is mainstreamed and well integrated into the public sector governance system.
<b>Indicator 4:</b>	The country has a functional management/normative.
<b>Indicator 5:</b>	The country has institutional development capacity.
<b>III. Procurement Operations and Market Practices</b>	
<b>Indicator 6:</b>	The country’s procurement operations and practices are efficient.
<b>Indicator 7:</b>	The country’s public procurement market functions well.
<b>Indicator 8:</b>	The country has contract administration and dispute resolution provisions.
<b>IV. Integrity of the Public Procurement System</b>	
<b>Indicator 9:</b>	The country has effective control and audit systems.
<b>Indicator 10:</b>	The country has an efficient appeals mechanism.
<b>Indicator 11:</b>	The public has broad access to information.
<b>Indicator 12:</b>	The country has ethics and anticorruption measures.

A joint GON-World Bank team applied the indicators to the Nepal's public procurement system from July 2006 to February 2007. By agreement, the team used a four-point scoring method in the assessment. The scoring options are listed below:

**Table 4.1: Procurement Assessment Indicators**

Baseline Achievements	Score	Assessment Key
Fully Achieved (FA)	4	Almost all benchmarks met.
Substantially Achieved (SA)	3	Some procedural deficiencies but most benchmarks met.
Partially Achieved (PA)	2	Procedural deficiencies exist, benchmarks partially met.
Not Achieved (NA)	1	Serious procedural deficiencies.

Table 4.2 provides scores for each of the indicators. (The text that follows provides a brief discussion of each of the indicators and sub-indicators)

**Table 4.2: Scores for Procurement Assessment**

<i>Process Indicator</i>	<i>Performance Data</i>	<i>Measure</i>	<i>Relation to Baseline Indicator</i>
Advertisement of bid opportunities	Percentage of open bidding procedures publicly advertised	Fairness, openness and level of competition	Legal and Regulatory (1) Access to Information (11)
Publication of Awards	Percentage of contract awards (should be based on monetary threshold)	Transparency of system	Legal and Regulatory (1) Access to information (11)
Time for preparation of bids	Average number of days between invitation to bid and bid submission	Fairness, competition	Legal and Regulatory (1)
Bidders participation	Average number of bidders submitting bid in each bid process	Effectiveness of competition and fairness	Functionality of Procurement market (7)
Bid acceptance/ Quality/ Responsiveness	Average number of bids/proposals received that are responsive to requirements in the bidding documents	Efficiency and effectiveness of the procurement market	Implementation Regulations and Tools (2) + Functionality of Procurement market (7)
Method of procurement	Percentage of usage for each authorized method of procurement	Effective use of competition	Legal and Regulatory (1)
Bid processing lead time	Average number of days from bid opening to the issuance of contract award	Efficiency and effectiveness	Institutional capacity(5) Efficiency of Procurement Operations and Practices (6)
Cancelled bidding process	Percentage of bid processes declared null before contract signing	Fairness and efficiency	Institutional capacity(5) Efficiency of Procurement Operations and Practices (6)

**Table 4.3 - Summary of Procurement Benchmark Indicator Assessment**

<b>Pillars and Indicators</b>	<b>Assessment</b>
<b>I. Legislative and Regulatory Framework</b>	
<b>Indicator 1:</b> Procurement legislative and regulatory framework complies with applicable obligations deriving from national and international requirements.	3
<b>Indicator 2:</b> Availability of implementing regulations, documentation and tools to support implementation of its framework.	2
<b>II. Institutional Framework and Management Capacity</b>	
<b>Indicator 3:</b> The public procurement system is mainstreamed and well-integrated into the public sector governance system.	1
<b>Indicator 4:</b> The country has a functional management/normative.	2
<b>Indicator 5:</b> The country has institutional development capacity.	2
<b>III. Procurement Operations and Market Practices</b>	
<b>Indicator 6:</b> The country's procurement operations and practices are efficient.	2
<b>Indicator 7:</b> The country's public procurement market functions well.	2
<b>Indicator 8:</b> The country has contract administration and dispute resolution provisions.	1
<b>IV. Integrity of the Public Procurement System</b>	
<b>Indicator 9:</b> The country has effective control and audit systems.	2
<b>Indicator 10:</b> The country has an efficient appeals mechanism.	2
<b>Indicator 11:</b> The public has broad access to information.	2
<b>Indicator 12:</b> The country has ethics and anticorruption measures.	2

## **Pillar I: Legislative and Regulatory Framework**

Nepal has enacted a Public Procurement Act (2007), based on UNCITRAL model law, which is a landmark achievement. The regulations related to this law have also taken effect. Subsidiary documents, including standard bidding documents and manuals remain to be prepared.

***Indicator 1: Procurement legislative and regulatory framework complies with applicable obligations deriving from national and international requirements.***

The baseline has been substantially achieved.

**Scope of application and coverage of the legislative and regulatory framework.** The Act is applicable to all entities including the parastatals; covers all areas of procurement including works, goods, and consulting services; and is applicable to all government procurement irrespective of contract value.

**Procurement Method:** The Act provides for different procurement methods. The following are the methods of public procurement:

- Open bidding through International Competitive Bidding (ICB) or National Competitive Bidding (NCB),
- Through call of sealed quotations,
- Direct contracting,
- Community, user community contracting, and
- Through Force-account.

Four methods are prescribed for the procurement of consulting services: (1) Quality and Cost Based Selection (QCBS), (2) Quality Based Selection (QBS), (3) Fixed Budget, and (4) Least Cost Method.

The conditions for the use of the above methods are fairly clear in the regulations. Open competitive bidding is the preferred method envisaged by the law and the regulations.

### ***Provision for advertising Procurement Notice***

The Act mandates that an invitation to tender be published in a national newspaper for all contracts of national level (NCB) and in the international media for tenders of international level (ICB). It also mandates that such notices are to be posted on the website of the concerned entities or of the central PPMO.

### ***Tender documentation and technical specifications***

The Act prescribes minimum content of the tender documents in Clause 13 (2) and the regulations (clauses 43-46) elaborate the requirements. The technical specifications have to be neutral with reference to international standards.

### ***Sufficient time for bid preparation***

The Act under clause 14 (4) provides for a bid preparation period of 30 days (minimum) for NCB and 45 days for ICB.

***Submission, receipt and opening of tenders (Bid opening in only one place, and immediately after submission deadline)***

The law has clear provisions for all of the above activities. It also stipulates that the tender documents are made available from two or more offices of public entities but submission has to be done at the one place notified in the bidding documents (Sub-clauses 5 and 6 of Clause 14).

***Preference to local bidders competing with foreign bidders***

The Act has the provision to provide preference to local bidders for ICB in accordance with the regulations. The preference would be as prescribed by the bidding documents.

***Evaluation of bids according to pre-disclosed criteria***

The Act, under 7 sub-clauses of Clause 25, requires bids to be evaluated based on criteria that have been disclosed in the bidding documents.

***Post-bidding negotiation with the lowest or any other bidder***

There are no provisions allowing for post-bid negotiations in the regulations.

***Contract award to lowest evaluated bidder***

Sub clause 35(8) of the Act mandates award recommendation only to the lowest-evaluated bidder.

***Requirement for public notice of contract awards***

The Act provides for posting the aforesaid information on the designated website.

***Bid rejection on the basis of price and participation***

The Act, Clause 26(b), provides that the purchaser may reject bidding if the bid price is substantially high compared to the estimate. Sub-clause 26(2) provides that bids shall not be rejected and re-invited only on the ground that a few bids or only one bid was substantially responsive.

***Bidders allowed, prior to the deadline for bid submission, to amend or withdraw their bids***

The Act allows the aforesaid under Clause 19.

***Larger civil works contractors not to be prohibited from competing against smaller contractors***

The repealing clause of the Act (Clause 75), Clause 9 and sub-clause 10(3) allowing all to bid addresses this issue adequately.

***A two-envelope system not to be used for the procurement of goods and works***

The Act does not allow two envelope systems in the procurement of goods and works.

***Indicator 2: Availability of implementing regulations, documentation and tools to support implementation of its framework***

The baseline has been partially achieved.

This indicator looks at the availability of implementing regulations and supporting documents. Sub-indicators probe different dimensions of the availability of regulations and instructions. The Public Procurement Act was approved in January 2007 and the regulations in August 2007, but none of the

other supporting documents exist. The Public Procurement Act calls for the creation of a full range of documents for successfully implementing and applying the law. In particular, the Act

- defines the processes and procedures,
- provides for the creation of model tender documents for goods, works and services,
- prescribes the procedures to be used for prequalification, and
- details the procedures for contracting services or other requirements in which technical capacity is a key criterion.

The general conditions for public sector contracts covering goods, works, and services are consistent with national requirements and, as applicable, international requirements.

## **Pillar II. Institutional Framework and Management Capacity**

This pillar examines the institutional capacity to oversee, manage and support efficient implementation as well as to provide leadership in modernizing and maintaining the public procurement system. It can be used at the level of the central Government, but can also be adapted to look at other levels of government.

### ***Indicator 3: The mainstreaming and integrating of the public procurement system into the public sector governance system***

The baseline has not been achieved.

Because of overall weaknesses in governance, the procurement system has not been mainstreamed and integrated into the financial management system.

#### ***Procurement planning and data on costing are part of budget preparation process***

The Act requires all government entities to prepare procurement plans as part of the annual budget exercise. However, the practice remains to be embraced universally. While in donor-funded projects, procurement planning, scheduling and cost estimating are mandated by legal agreement, and are carried out mostly by the project director and the engineer (who is experienced in procurement), a similar exercise is not usually done for Government-funded procurement. Usually, very rough project costing is done during budget preparation and in rare cases, a department may do some rudimentary procurement planning. Due to the absence of such plans, monitoring and reporting of procurement actions is inadequate and weak.

Normally, procurement plans are not prepared in advance, and when done, they are not detailed. The scheduling is ambitious and does not anticipate or cater to inevitable delays in evaluation and internal decision-making. In civil works contracts, the completion periods are specified on an ad-hoc basis, mostly with no rationale other than to attempt completion and expenditure within the end of the relevant fiscal year. Contract packaging is not considered or carried out for economy and efficiency. The Act mandates proper procurement planning.

#### ***Budget, contract execution and payments***

In most cases, technical and financial planning is not coordinated. In addition, there are no assurances that funds will be available for completing on-going projects even if budgeted-for in GON-funded projects. The budget is allocated against programmed items approved by NPC for the year in question. The budget allocation in the program may contain an item that says “payment for the work done during the previous fiscal year”.

The status on the related sub-indicators is:

- (a) Procurement planning and data on costing are not part of the budget formulation process.
- (b) Budget law has no specific provision in support of the timely procurement and payments but the financial and procurement procedures do support timely procurement, contract execution and payment.
- (c) Procurement actions are not initiated until budget appropriations have been made.
- (d) Contract execution is subject to budgetary controls to ensure sufficient funding for contract.
- (e) Budgeting system does not provide for timely release of funds to make payments against contractual obligations.

***Indicator 4: Functional management of procurement by a public procurement body***

The baseline has been partially achieved.

Prior to the enactment of the new law, Nepal had no entity like a Central Tender Board that would have oversight over procurement functions. The FCGO was entrusted with the regulatory powers. It, among other important functions, drafted and obtained government approval to the financial administration-related regulations including procurement and the Standard Bidding Documents. These functions have shifted to the PPMO, which was established in September 2007.

The concept of a PPMO is new and has been included in the Act and the regulations. The arrangements provide for:

- (a) The status and basis for the public procurement policy agency; and
- (b) Its functions that include: providing advice to contracting entities, drafting amendments to the legislative and regulatory framework and implementing regulations, monitoring public procurement, providing procurement information, managing statistical databases, reporting on procurement to other parts of Government, developing and supporting implementation of initiatives for improvements of the public procurement system, and providing implementing tools and documents to support training and capacity development of staff.
- (c) The Procurement Act also provides that the PPMO will not have direct involvement in the execution of procurement transactions, though its chief has been designated as one of the members of the committees to examine and recommend variation orders exceeding 15% of contract values for Cabinet approval.
- (d) With the Act coming into force, this policy agency should have adequate autonomy, funding, staffing and independence and authority (formal power) to exercise its duties.

***Indicator 5: Existence of institutional development capacity***

The baseline has been partially achieved.

The current public procurement system has significant weaknesses as regards measures for providing information on procurement, building procurement capacity and monitoring and reporting on performance. The following dimensions reflect the weaknesses.

- (a) The system does not provide for collecting and disseminating procurement information, including tender invitations, requests for proposals and contract award information except for the publication of notices in the national newspapers.
- (b) In terms of providing training, the Institutional Development Fund (IDF) grant supported by IDA (closed in 2006) provided some impetus for improving the situation. Nepal Administrative Staff College (NASC) has created a Procurement Faculty, which is now responsible for managing procurement training programs. NASC has developed a network of procurement trainers who can be contracted for training. However, Nepal needs a sustainable strategy for providing training, advice and assistance to help the Government and private sector participants to understand what the rules and regulations are and how they should be implemented. The Act may help in this regard.
- (c) The country has no systems and procedures for collecting and monitoring national procurement statistics.
- (d) Quality control standards are disseminated but are rarely used to evaluate staff performance and for addressing capacity development issues.

The Act provides for substantial strengthening of institutional arrangements for procurement. Ensuring that new procedures and practices are put in place will be one of the prime challenges in implementing the law.

### **Pillar III. Procurement Operations and Market Practices**

In a well-functioning system, an efficient and competitive private sector is a key partner in the public procurement system. Unfortunately, private sector competition for state contracts is neither robust nor dynamic. Private sector firms appear to lack confidence in the competence and fairness of the contracting authorities for implementing and administering the public procurement system in accordance with the legislative and regulatory framework.

#### ***Indicator 6: Efficient procurement operations and practices***

The baseline has been partially achieved.

The efficiency of procurement operations and practices depend on staffing, knowledge, skills and capabilities of human resources. Individual behavior is shaped by the system incentives and controls that influence human behavior and institutional performance on the one hand, and an equally efficient and responsive private sector on the other.

The level of procurement competence among government officials within the entity, except in a few cases, is not consistent with their responsibilities. The country has a severely limited number of officials with adequate training and competency in procurement. There is a perception that procurement and contract management competency is declining, including at agencies that previously had a reputation for competency. Growing questions on performance could have resulted from the reluctance of officials to take procurement decisions for fear of scrutiny and unnecessary probing by oversight agencies such as the CIAA. The declining performance may also be due to inadequate procurement knowledge of staff. Following points reflect the current status:

- (a) The procurement training and information programs for government officials and private sector participants are not consistent with demand. A modest start has been made in this direction and it is expected to improve further. To assure continuity in

training, there is a need to institutionalize capacity building, which has been done through NASC.

- (b) Nepal lacks appropriate administrative systems for public procurement operations and information databases to support performance monitoring and reporting, and to respond to the information needs of other, related, government systems.
- (c) The procurement entities have no internal control mechanisms governing operations at the contracting level. Procurement operations are not supported by a code of conduct, separation of responsibilities as a check and balance mechanism, or oversight/control of signature/approval authority.
- (d) Although there are no established norms for safekeeping records and documents related to transactions and contract management, the entities do keep records safely for auditing—and possible enquiries.
- (e) There are provisions for delegating authority to others who have the capacity to exercise the responsibilities.

Procurement skills appear to be particularly weak in the area of contracting consultants, with clear performance issues relating to quality and speed. Short-listing is not done properly. Nonperforming and poorly-performing consulting firms are also included in the shortlist. In many cases, the Terms of Reference (TOR) are not detailed enough, and do not fully capture the objectives of the assignment. Request for Proposal (RFP) documents are not tailored for the particular job—especially the evaluation criteria which are either incorrectly formulated or do not focus on the critical needs and aspects of the assignment. The RFPs are often designed in a manner that makes the evaluation a mechanical exercise by not allowing full appreciation or grading of the qualitative differences among proposals. Technical proposals are not evaluated properly.

#### ***Indicator 7: Functionality of public procurement market***

The baseline has not been achieved.

The domestic market is relatively small. There are several manufacturers producing items of general consumptive use, and Nepal has relatively well-developed trading, farming and construction sectors. However, the market for state contracts does not function well. There are indications of collusion among the contractors in works contracts. Bid rates for same or similar work items obtained from smaller number of pre-qualified contractors are invariably high compared with bidding with larger participation under the post-qualification mechanism. The same issues do not seem to be present in goods procurement.

The baseline is defined by the following sub-indicators:

- (a) An independent complaint review system has become a reality under the Act. When it becomes operational, participants in the public procurement process would be able to file complaints within the framework of an administrative and judicial review procedure.
- (b) Theoretically, the decisions of the complaint review board are deliberated on the basis of available information. The decisions of the enforcement body can be appealed at the civil courts.
- (c) Decisions are to be posted on the website and also made available to all interested parties and the public.

- (d) Although Nepal's private sector is sufficiently developed to support competition for state contracts, healthy competition seems to be lacking. Procurement is characterized by cut-throat competition in some areas and wide-spread collusion in others.
- (e) The public sector pays much higher prices for goods, works and services in comparison to the prices paid for similar requirements in the domestic markets.
- (f) The quality of the bidding by the private sector is lacking in many respects, including rates, information furnished and compliance to the bidding documents.
- (g) There is active bidder participation in procurement when it comes to the purchasing of bidding document. However, only a small proportion of the potential bidders, often between 10 to 20%, actually submit bids. It has not been possible to determine the rationale for this behavior.

***Indicator 8: Existence of contract administration and dispute-resolution mechanism***

The baseline has been substantially achieved.

The baseline is defined by the following sub-indicators.

- (a) Public Works Directives clearly defines procedures for undertaking contract administration responsibilities, including efficient and streamlined inspection and acceptance procedures, quality-control procedures, and methods to review and amend contracts in a timely manner.
- (b) Contracts include dispute-resolution procedures that provide for an efficient and fair process for settling disputes arising during performance of contract.
- (c) Procedures exist to enforce the outcome of the dispute resolution process, though enforcement could be time consuming.

**Pillar IV. Integrity of the public procurement system**

***Indicator 9: Effective control and audit systems***

The baseline has been partially achieved.

The FCGO carries out internal audits and releases funds through its district offices to the implementing entities. OAG is responsible for external audits. FCGO would issue instructions to the procuring entities to regularize the transactions if found to be otherwise, through internal audits. However, the follow-up on audit observations is weak.

The baseline is defined by the following sub-indicators.

- (a) A legal framework, organization, policy and procedures for internal and external control and audit of public procurement operations are in place to provide a functioning control framework—though somewhat deficient.
- (b) Enforcement and follow-up on findings and recommendations of the control framework is inadequate and does not provide an environment that fosters compliance. Non-compliance of recommendations is substantial.

- (c) The internal control system does not provide timely information on compliance to enable department (management) to take action.
- (d) There is a need to have a control systems sufficiently defined to allow performance audits (procurement and financial).
- (e) Auditors are not sufficiently informed about procurement requirements and control systems for conducting quality audits that would contribute to compliance.

***Indicator 10: Existence of an efficient appeals mechanism***

The baseline has been fully achieved in terms of legal provision but implementation remains to be seen.

The Act has provisioned for adequate appeals mechanism (clause 47) through creation of a review committee under Clause 48. How the appeal mechanism would function remains to be seen.

***Indicator 11: Degree of access to information***

The baseline has been partially achieved.

The Act provides for public notification upon completion of the procurement contract in accordance with the regulations. It also requires posting of award information, etc. on the website of the public procurement agency. **Full compliance remains to be tested.** Nepal has a Right to Information Act that allows citizens to demand and obtain information including that on procurement.

***Indicator 12: Ethics and anticorruption measures***

The baseline has been partially achieved.

Clause 61 of Chapter 8 of the Procurement Act has a specific provision on ethics and disclosure of conflict of interest by the public official involved in procurement. Similarly, clause 62 specifies the conduct of bidders.

The baseline is defined by the following sub-indicators:

- (a) The legal and regulatory framework for procurement does not include provisions for addressing corruption except for the intended purpose of controlling collusion. The procedure for deduction and action is not specified. The tender and contract documents, however, include provisions for addressing corruption, fraud, conflict of interest but do not articulate (either directly or by reference to other laws) the actions that can be taken with regard to such behavior.
- (b) The legal system related to public procurement does not define responsibilities, accountabilities and penalties for individuals and firms found to have engaged in fraudulent or corrupt practices. These are included in the anti-corruption law.
- (c) Rulings and penalties are not perceived as being enforced.
- (d) Theoretically, the Government has an anticorruption program that provides, and enforces, special measures to prevent and detect potential fraud and corruption in public procurement in accordance with criminal laws.

- (e) Stakeholders (private sector, civil society and ultimate beneficiaries of procurement/end-users) support the creation of a procurement market known for its integrity and ethical behaviors.
- (f) The country should have in place a secure mechanism for reporting fraudulent, corrupt or unethical behavior.



## **V. CONCLUSIONS AND RECOMMENDED ACTIONS FOR PUBLIC PROCUREMENT REFORM**

The overriding objective of a national public procurement system is to deliver efficiency and value for money in the use of public funds, while adhering to the fundamental principles of non-discrimination, equal treatment and transparency. Procurement is therefore at the core of the Public Financial Management (PFM) system and contributes greatly to several of its objectives, including efficiency, transparency and accountability.

Parliament approved the Public Procurement Act 2063 (2007) in January 2007 and the government issued the Public Procurement Regulations in August 2007. These instruments have established a new framework for regulating, managing, executing and overseeing procurement in Nepal. The Act is a significant step towards a modern procurement system. Implementation of the Act is a major challenge for the public sector. It will require the dedication of significant GON resources as well as donor support for translating the Act into improved procurement outcomes.

The Public Procurement Monitoring Office (PPMO) was established in September 2007 and is headed by a full-time secretary. PPMO reports directly to the Office of the Prime Minister and Council of Ministers. It needs to be groomed into a technically competent authority for delivering an efficient and effective procurement management system. The main challenges relating to implementation of the Act are as follows:

- Creating awareness of the basic elements of the Act and the improvements made in procurement procedures among Government, civil population and private sector;
- Institutional strengthening of PPMO, the lead procurement regulator, and an independent complaints review mechanism;
- Adopting new procedures and practices within executing agencies (including e-Government procurement),
- Establishing mechanisms to monitor implementation and performance, including efficient and reliable communication systems for timely reporting of procurement actions/status and instilling the culture of regular reporting; and
- Building knowledge of the Act among stakeholders and training public and private officials at all levels in procurement and the skills needed to plan, manage, execute and oversee the new practices.

A strategy for supporting implementation of the Public Procurement Act will need to address the following key obstacles:

- The absence of a clear champion for procurement reform in Government leadership,
- The absence of officials in GON with significant experience and/or expertise in managing, regulating, executing and overseeing procurement—especially at sub-national levels;
- The opposition to the new law by the construction industry,
- Provisions in the law that establish cumbersome procedures for modifying contracts;
- Relatively limited degree of integration of procurement in the overall PFM system, and lack of incentives for good procurement (i.e. savings generated by improved procurement are not retained by the executing agency); and
- Issues related to transparency/ corruption.

Support for the implementation of the Public Procurement Act should have three primary components:

- Technical and organizational work directed at putting in place the key features of the Act,
- Work on mainstreaming procurement in the PFM system and establishing incentives for high-performance within executing agencies, and
- Work directed at establishing a constituency inside and outside of Government to push for implementation.

GON will take a lead to drive procurement reform with support from development partners. The PPMO will be staffed with capable human resources, who can be trained and supported for handling procurement reforms. GON will need to develop and implement a large-scale capacity building program for procurement staff. It will also consider the possibility of developing a separate cadre of employees for integration into the civil service to ensure that only accredited personnel handle the procurement function.

**PART C:**

**NAMES OF  
INDIVIDUALS  
INVOLVED IN THE  
PEFA PROCESS**



## C. NAMES OF INDIVIDUALS INVOLVED IN THE PEFA PROCESS

**Table A5.1: PEFA - Working Committee**

<b>Advisor: Sushil Prasad Sharma Dhungel, Financial Comptroller General (Retired)</b>			
<b>S.No</b>	<b>Name</b>	<b>Designation</b>	<b>Office</b>
1	Deba Raj Pathak	Joint Financial Comptroller General (Coordinator)	FCGO
2	Babu Ram Gautam	Director	OAG
3	Ram Saran Pudasaini	Under Secretary	MOF
4	Bharat Mani Subedi	Under Secretary	NPC
5	Dhruba Prasad Dahal	Under Secretary	MOLD
6	Diwakar Prasad Rimal	Deputy Financial Comptroller General	FCGO
7	Bhagirath Panday	Deputy Financial Comptroller General	FCGO
8	Shiva Prasad Pandit	Deputy Financial Comptroller General	FCGO
<b>PEFA Support Team</b>			
9	Shyam Uprety	Computer Assistant	FCGO
10	Navin Shrestha	Accounts Assistant	FCGO
11	Guru Prasad Sharma	Accounts Assistant	FCGO
<b>World Bank Team</b>			
10	Bigyan Pradhan	Sr. Financial Management/Operations Specialist (Task Leader)	
11	Roshan Bajracharya	Sr. Economist (Task Leader)	
12	Uche Mbanefo	Consultant	
13	Chandra B. Nemkul	Consultant	
14	Pradeep Shrestha	Consultant	
15	Kiran Ranjan Baral	Sr. Procurement Specialist	
16	Joel Turkewitz	Lead Procurement Reform Specialist	
17	Narayan D. Sharma	Procurement Consultant	
18	Binod Bhattacharai	Consultant (Editor)	
19	Nagendra Nakarmi	Senior Program Assistant	

**Table A5.2: PEFA – Sub-working Committee**

S.No.	Group
<b>Group 'A'</b>	
1	Ram Saran Pudasaini, Ministry of Finance (MOF), Coordinator
2	Prem Prasad Dhungana, Financial Comptroller General Office (FCGO)
3	Rajendra Bajracharya, FCGO
4	Bharat Mani Subedi, National Planning Commission (NPC)
5	Ritu Rajbhandari, Ministry of Women, Child and Social Welfare (MOWC&SW)
6	Binod Kumar Devkota, Ministry of Education & Sports (MOES)
7	Durga Rayamajhi, FCGO
8	Durgesh Kumar Pradhan, MOF
<b>Group 'B'</b>	
1	Shyam Dahal, MOF, Coordinator
2	Bishnu Prasad Nepal, MOF
3	Rammani Dawadi, Inland Revenue Department (IRD), MOF
4	Prakash Man Shrestha, IRD, MOF
5	Diwakar Rimal, FCGO
6	Bhagirath Pandey, FCGO
7	Dilip Chapagain, Ministry of Local Development (MOLD)
8	Jeeban Prasad Subedi, Office of the Auditor General (OAG)
9	Krishna Bahadur Raut,NPC
10	Pradeep Shrestha, World Bank, Consultant
<b>Group 'C'</b>	
1	Nirmal Hari Adhikari, MOF, Coordinator
2	Babu Ram Gautam, OAG
3	Geh Nath Gautam, Prime Minister's Office (PM Office)
4	Rishi Lamichhani, Ministry of Health & Population (MOHP)
5	Lava Dev Avasthi, MOES
6	Reshma Raj Pandey, MOLD
7	Binod K.C., Ministry of Industry, Commerce & Supplies (MOICS)
8	Janardan Neupane, FCGO
9	Durgesh Kumar Pradhan, MOF,
<b>Group 'D'</b>	
1	Ram Saran Pudasaini, MOF, Coordinator
2	Bharat Mani Subedi, NPC
3	Mahesh Dahal, MOLD
4	Dhurba Prasad Dahal, MOLD
5	Lok Bilash Pant, MOES
6	Rajendra Bajracharya, FCGO
7	Purna Bhakta Tandukar, FCGO
8	Maheswar Kafle, OAG
9	Durgesh Pradhan, MOF
<b>Group 'E'</b>	
1	Madhu Marasini, MOF, Coordinator
2	Pradip Shrestha, NPC
3	Padmaraj Bhatta, FCGO
4	Suresh Pradhan, Revenue Administrative Training Center (RATC)
5	Bhagirath Pandey, FCGO
6	Lava Dev Awasthi, MOES
7	Dr. Baburam Marasini, MOHP
8	Bashistharaj Adhikari, Ministry of Water Resources (MOWR)
9	Keshav Kumar Sharma, MOWR
10	Prabin Raj Aryal, MOWR
11	Ratna Kumar Shrestha, Department of Education (DOE)

<b>Group F</b>	
1	Diwakar Rimal FCGO, Coordinator
2	Shiva Prasad Pandit., FCGO
3	Bhagirath Pandey, FCGO
4	Babu Ram Gautam, OAG
5	Pradeep Kumar Shrestha, Consultant, World Bank
6	Chandra Bahadur Nemkul, Consultant, World Bank

  

<b>Group 'G'</b>	
1	Babu Ram Gautam, OAG, Coordinator
2	Padma Raj Bhatta, FCGO
3	Bhava Krishna Bhattarai, FCGO
4	Deepak Shankar Malla, FCGO

  

<b>Group H</b>	
1	Shakti P. Shrestha, FCGO (Retired), Coordinator
2	Suresh Pradhan, Revenue Administration Training Center
3	Shambhu K.C., Department of Urban Development and Building Construction (DUDBC)
4	Shambhu Upfrey, DOE
5	Dwarika Acharya, Ministry of Foreign Affairs (MOFA)
6	Deepak Man Singh, Department of Roads (DOR)
7	Prem Dhungana, Ministry of Water Resources (MOWR)
8	Krishna B. Khadka, Nepal Administrative Staff College

**Table A5.3: Dissemination of PEFA Indicator Assessment Draft Report**

S.No.	Name	Designation	Address
1	Dr Ram Saran Mahat	Minister for Finance	MOF
2	Bacchu Ram Dahal	Acting Auditor General	OAG
3	Vidyadhar Mallik	Finance Secretary	MOF
4	Rameshore Khanal	Finance Secretary(Revenue)	MOF
5	Ramchandra Man Singh	Secretary	MOHP
6	Bhadreswar Upadhyaya	Deputy Auditor General	OAG
7	Ramesh Raj Satyal	Deputy Auditor General	OAG
8	Badri Bahadur Karki	Deputy Auditor General	OAG
9	Balananda Poudyal	Secretary	MOES
10	Avinindra Shrestha	Secretary	MOPR

**Table A5.4: Officials who Commented on PEFA Indicator Assessment Draft Report**

S.No.	Name	Designation	Address
1	Yub Raj Bhusal	Joint Secretary	Office of the Council of Minister and Prime Minister
2	Madhav Ghimire	Joint Secretary	Ministry of Finance
3	Krishna Hari Baskota	Joint Secretary	Ministry of Finance
4	Rana Bahadur Shrestha	Joint Secretary	Ministry of Finance
5	Ganga Detta Avasthi	Joint Secretary	Ministry of Local Development
6	Pratap Kumar Pathak	Joint Secretary	Ministry of Home Affairs
7	Khem Prasad Dahal	Joint Auditor General	Office of the Auditor General (OAG)
8	Bimala Subedi	Joint Auditor General	OAG
9	Dev Bahadur Bohara	Joint Auditor General	OAG
10	Mahesh Guragain	Director	OAG
11	Bal Govinda Bista	Director General	Customs Department
12	Som Lal Subedi	Joint Secretary	Ministry of Local Development
13	Durga Nidhi Sharma	Joint Secretary	Ministry of Peace and Reconstruction
14	Laxman Kumar Pokharel	Director General	Customs Department
15	Bodha Raj Niraula	Joint Secretary	Ministry of Education & Sports
16	Kedar Bdr Adhikari	Deputy Director General	Inland Revenue Department
17	Ramesh Kumar Sharma	Deputy Director General	Department of Revenue Investigation
18	Tanka Mani Sharma	Registrar	Cooperative Department
19	Gita Shrestha	Joint Secretary	National Planning Commission
20	Khagendra Mani Pokhrel	Joint Secretary	Department of Transport Management
21	Jaya Dev Shrestha	Joint Secretary	FCGO
22	Hari Kumar Shrestha	Joint Secretary	CIAA
23	Suresh Pradhan	Under Secretary	Revenue Administration Training Center

**Table A5.5: Development Partners with whom the Draft Assessment Report was shared in May 2007 for Comments**

S.No.	Name	Designation	Office
1.	His Excellency Tori Toreng	Ambassador	Royal Norwegian Embassy, Bakundole, Lalitpur, Nepal
2.	His Excellency Finn Thisted	Ambassador	Royal Danish Embassy, Baluwatar, Kathmandu, Nepal
3.	His Excellency Franz Erwin Ringh	Ambassador	Embassy of the Federal Republic of Germany, Gyaneshwar, Kathmandu, Nepal.
4.	His Excellency Michel Jolivet	Ambassador	Embassy of the French Republic Lazimpat, Kathmandu, Nepal
5.	Kenichi Ohashi	Country Director	World Bank Kathmandu, Nepal
6.	Bella Bird	Head	DFID Jawalakhel.
7.	Paolo Spantigati	Senior Economist	Asian Development Bank Kamaladi, Kathmandu.
8.	Alexander Pitt	Resident Representative	International Monetary Fund, C/O Nepal Rastra Bank, Thapathali, Kathmandu, Nepal.
9.	Matthew Kahane	Resident Representative	UNDP Pulchowk, Nepal.
10.	Shinji Yoshiura	Resident Representative	Japan International Cooperation Agency (JICA) Pulchowk, Nepal
11.	Jorg Frieden	Country Director	Swiss Cooperation Office Kathmandu, Nepal

**Table A5.6: List of Government Officers Consulted on Development Action Plan**

S.No.	Name	Post	Office
1.	Shiva Bahadur Rayamajhi	Joint Secretary	Ministry of Finance
2.	Bimal Wagle	Joint Secretary	Ministry of Finance
3.	Rana Bahadur Shrestha	Joint Secretary	Ministry of Finance
4.	Lal Mani Joshi	Joint Secretary	Ministry of Finance
5.	Binod Babu Kafle	Under Secretary	Ministry of Finance
6.	Ganga Dutta Avasthi	Officiating Secretary	Ministry of Local Development
7.	Laxman Pokharel	Director General	Customs Department
8.	Maheswor Prasad Sharma	Director General	Inland Revenue Department
9.	Sant Bahadur Shrestha	Deputy Director General	Inland Revenue Department
10.	Sant Raj Subedi	Deputy Director General	Inland Revenue Department
11.	Prabhu Ram Bhandary	Chairman	Auditing Standards Board
12.	Narayan Raj Tiwari	Former Secretary	
13.	Sushil Prasad Sharma	Former FCG	
14.	Madhav Prasad Ghimire	Former FCG	
15.	Bansidhar Ghimire	Former FCG	