Nepal: Integrated Public Financial Management Reform Project (P164783)
Preparation Consultations
November 6-10, 2017
Aide Memoire (AM)

1. During November 6-10, 2017, a Bank team1 led by Jiwanka Wickramasinghe, carried out consultations on the preparation of the proposed Integrated Public Financial Management Reform Project (IPFMRP). This Aide Memoire (AM) summarizes the findings on the project scope and costs, implementation arrangements, results framework and fiduciary and safeguards arrangements. The AM was discussed at the wrap-up meeting on November 10, 2017 which was chaired by Dr. Baikutunga Aryal, Joint Secretary, International Economic Cooperation Coordination Division, Ministry of Finance (MoF) and participated by Mr. Kewal Bhandari, Joint Secretary, Budget and Program Division, MoF and Mr. Murari Niraula, Member Secretary of PEFA Secretariat. As agreed at the wrap up meeting, this AM will be classified as a public document under the World Bank’s Access to Information Policy.

2. The team discussed the Bank’s Access to Information Policy that applies to the proposed Project and agreed on the public disclosure of the Project Information Document (PID) and Integrated Safeguards Data Sheet (ISDS).

3. Proposed Project Scope: The development objectives of the proposed Project are to: (a) streamline capital project appraisal and selection procedures in selected sectors; (b) adopt a reporting and budgeting framework suitable for the new federal structure; (c) make available timely annual financial statements to the public aligned with international standards; and (d) improve internal control procedures. The draft indicators discussed to measure the achievement of the Project Development Objectives (PDOs) include: (a) simplified, updated guidelines on project screening, appraisal and prioritization implemented in two pilot subsectors; (b) reporting and budgeting guidelines developed and adopted to suit the new federal structure; (c) annual financial statements aligned with international standards are prepared and published in a timely manner; and (d) national and line ministry/sector level internal control guidelines are developed and approved for adoption. The longer-term impact of these results can be found in Annex 2.

4. Four priority areas have been identified for support by way of strengthening systems, processes and capacity: (1) public investment management and budgeting; (2) public financial management (PFM) improvements in subnational governments; (3) fiscal reporting and controls and (4) establish arrangements to mainstream capacity building and management of PFM reforms. Embedded in these components are three noteworthy areas that the government considers as essential to move the Public Financial Management (PFM) reform agenda forward. These include support to strengthening budgeting, obtaining membership in the Open Government Partnership and designing of preliminary steps towards improving revenue management. The detailed subcomponents, activities and the intermediate results under these four priority areas are attached in Annex 3.

5. Proposed Project Cost and Financing: The proposed Project is intended to be funded by a MDTF for Public Financial Management. The proposed project design will anchor on the integrated PFM reform plan prepared by a multi-agency task force mandated by the PFM steering committee. In addition, a rapid assessment of subnational PFM arrangements was carried out to factor in the new federal structure of governance. Government’s Public Financial Management Reform Program (PFMRP) is costed at USD 25 million to support 13 implementing agencies2. High priority areas from

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1 Jiwanka Wickramasinghe (Task Team Leader (TTU Sr. Financial Management Specialist); Franck Bessette (Co-TTU/Manager MDTF for PFM reform) Michael Schaeffer (Sr. Public Sector Specialist); Mohammed Reza (Sr. Financial Management Specialist); Yogesh Bhan Mall (Sr. Financial Management Specialist); Timila Shrestha (Financial Management Specialist); Surya Pratap Bhatt (Economist); Shambhu Prasad Upadhyay (Procurement Specialist); Drona Raj Ghimire (Sr. Environmental Specialist); Luiza Nora (Social Development Specialist); Anjalee Maya Thakali (Consultant); Pragya Shrestha (Consultant); Shraddha Shah (Consultant); and Sheeram Ghimire (Team Assistant). Remote support was provided by Khurram Farooq (Sr. Financial Management Specialist).

2 Ministry of Finance (Budget and Program Division, IECD, Revenue Management Division); FCGO; Office of the Auditor General; National Planning Commission; Public Accounts Committee (PAC) Secretariat; MoFALD; Ministry of Education; Ministry of Health; Public Procurement Monitoring Office (PPMO); PEFA secretariat; Institute of Chartered Accountants Nepal, National Reconstruction Authority.
the strategy as well as emerging areas of priority have been selected for support under the proposed Project to align with resource availability. The cost estimate of these prioritized activities of the IPFMRP amount to USD 12 million. The Government has expressed their interest to contribute 20% as counterpart funds towards the cost of the prioritized activities.

6. **Retroactive Financing:** It was agreed that the Government will use the retroactive financing option (up to a ceiling of 20% of the estimated MDTF contribution as retroactive financing for payments made by the Government not more than 12 months before the expected date of signing of the Grant agreement) to provide immediate support required to establish PFM arrangements for the new federal structure and to also complete some key spill over activities from SPFM II that closed on July 31, 2017. Accordingly, a list of such activities that aligns with the proposed project development objectives were approved by the Bank for retroactive financing. The Bank team reminded the Government that activities that are covered by retroactive funding should follow World Bank procurement procedures.

7. **Readiness filter:**
   
a) Procurement plan in Systematic Tracking of Exchanges in Procurement (STEP)
   
b) Project Procurement Strategy for Development (PPSD)
   
c) Form core project team for implementation

8. **Financing instrument:** The Project will be financed using the ‘Recipient Executed (RE) Investment Project Financing (IPF)’ instrument. This instrument has been selected as the project has clear objectives, activities and results that will be achieved by financing a clear set of expenditures.

9. **Implementation Arrangement:** As part of its effort to strengthen PFM systems and coordinate reforms, the GoN established a PFM Steering Committee (an apex body of overall PFM reforms) and set up a Public Expenditure and Financial Accountability (PEFA) Secretariat in 2008. Since then these arrangements have been used to coordinate and monitor the Strengthening Public Financial Management (SPFM) I and II projects. The government has decided to follow this oversight and coordination mechanisms for all PFM related interventions of the Government going forward as the government aims for an integrated approach to PFM initiatives. Accordingly, the same coordination arrangement will continue for the proposed Project. The implementation of project activities will rest with ministries, departments and agencies of the Government, aligned with their institutional mandate. This arrangement will ensure the operational independence of all implementing agencies. Project Implementing Units consisting of existing staff will be formed by each agency. These focal groups to give greater attention to project implementation and make way for efficient project coordination with the PEAF Secretariat.

10. **Fiduciary Arrangement:**

   a) **Procurement Arrangement:** The PEFA Secretariat has gained extensive experience of Bank procurement procedures as the implementing agency of SPFM I and II. Procurement staff are on board at the Secretariat and a draft list of procurement activities has been prepared and submitted to the Bank. For the proposed Project, procurement procedures under the new procurement framework of July 1, 2016 will be applicable. For this, the implementing agency will require to prepare a ‘Project Procurement Strategy for Development (PPSD)’. The Bank will work with the PEFA Secretariat to build awareness on the required procedures for preparation of the PPSD as well as the preparation of a procurement plan in Systematic Tracking of Exchanges in Procurement (STEP).

   b) **Financial Management (FM) Arrangement:** The responsibility for financial management arrangements of the Project will rest with the PEFA Secretariat. Finance Officers are already on board to ensure effective financial management in line with the
government policies and procedures. The project team needs to particularly focus on timeliness of trimester financial reports and annual audit report. The financial report will be submitted within 45 days from the end of each trimester and the annual audit report audited by the Office of the Auditor General within six months from the fiscal year-end. The Bank will provide continuous support to enhance the capacity of the implementing agencies to meet these requirements.

11. **Safeguard Arrangement**: The Project is classified as a Category C project as adverse environmental and social impact due to project activities is not envisaged. However, at any given time, if any civil works like construction of building is carried out or there is treatment/disposal of old computers and if identified as a linked activity then the Government should undertake environmental and social screening and assessment meeting the Bank’s safeguards and standards, and appropriately address any issues identified.

12. **Corporate Requirements:**

   a) **Citizen Engagement and Gender**. Citizens engagement (CE) is an area of priority identified in the PFM reform plan. The Project will support the development and implementation of a citizen engagement strategy. Emerging entry points for CE include the disclosure of information on the use of public funds to facilitate citizen’s participation and awareness creation among citizens on key financial information as a way of encouraging greater participation. The Government also expressed specific interest in engaging in Open Government Partnership (OGP). The Bank team has advised the Government on the process steps required to obtain OGP membership and extends support required to obtain membership and implement plans. The training needs assessment that will be carried out under the Project will have a gender focus. Project will aim to increase the number of trained females in PFM.

   b) **Climate Change**. The impact of climate change on project activities is minimal as the project procurement activities will include services and goods only, and not works.

13. **Check list for Appraisal**: Appraisal of the proposed project will be completed upon satisfactory completion of the following activities by the Government:

   - Finalization of the overall design including the Project Development Objective, Project scope and results framework.
   - The preparation of the Project Procurement Strategy for Development (PPSD) and the procurement plan in STEP
   - Formation of the Project Implementing Units at the implementing agencies.

14. **Proposed Key Timeline for Processing**.

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<tbody>
<tr>
<td>Appraisal</td>
<td>During the month of February 2018</td>
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<tr>
<td>Bank Approval</td>
<td>During the month of March 2018</td>
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Annex 1: List of Persons Met

Ministry of Finance
1. Mr. Shankar Prasad Adhikari, Finance Secretary
2. Dr. Baikuntha Aryal, Joint Secretary, IECCD
3. Mr. Kewal Prasad Bhandari, Joint Secretary, Budget and Program Division
4. Mr. Adesh Kahdka, IT Director

PEFA Secretariat
5. Mr. Damodar Regmi, Coordinator
6. Mr. Murari Niraula, Member Secretary
7. Mr. Rajendra B. Bajracharya, PFM National Consultant
8. Mr. Shreeram Thakur, Accounts Officer
9. Ms. Laxmi Tiwari, Accounts Officer
10. Mr. Prithiviman Limbu, Accounts Officer
11. Ms. Bidhya Adhikari, Accounts Officer

Financial Comptroller General Office
12. Mr. Hem Raj Paudel, Under Secretary
13. Mr. Sansar Jung Dewang, IT Director

National Planning Commission Secretariat
14. Mr. Khom Raj Koirala, Joint Secretary
15. Mr. Chakrapani Acharya, Under Secretary

Institute of Chartered Accountant Nepal (ICAN)
16. Mr. Prakash Jung Thapa, President
17. Mr. Jagannath Upadhyay, Vice President
18. Mr. Sanjaya Kumar Sinha, Executive Director
### Annex 2: Expected Long-term Impact of Project Activities

The Project is expected to lay the foundation for a robust public financial management system including processes and institutions in the federal structure which would ultimately result in efficiency in public spending, enhanced accountability, improved transparency and greater citizen’s participation. The longer term impact of the expected project results are depicted in the table below.

<table>
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<th>PDO Level Results</th>
<th>Expected Outcomes Beyond Project Life Time</th>
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| Simplified, updated guidelines on project screening, appraisal and prioritization implemented in pilot subsectors | • Greater accountability - All large capital projects are adequately assessed –  
• High quality capital spending - Capital budget is derived from a prioritized list of pipeline projects  
• Capital budget outturns are satisfactory  
• Project Implementation is timely  
• Capital assets are adequately maintained/ there is adequate maintenance budget |
| Reporting and budgeting guidelines developed and adopted for all 3 tiers of Government | • Improve the orderliness of the budget preparation process leading to an improvement in the quality of the budget and the timely approval of the budget  
• Timely reporting by SNGs |
| Annual financial statements aligned with international standards are prepared and published in a timely manner. | • Greater transparency of fiscal activities  
• Informed decision making leading to an improved fiscal position, reduction in fiscal risks |
| National and sector level internal control guidelines are developed and in effect | • A reduction in audit observations relating to lack of compliance  
• Adequate commitment controls. |
## Annex 3: Detailed Project Design

<table>
<thead>
<tr>
<th>Components</th>
<th>Public Investment Management and Budget</th>
<th>PFM Improvements in Subnational Governments</th>
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<th>Mainstream Capacity Building and Management of PFM reforms</th>
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| **Subcomponents**           | • Improve the project section function for capital projects  
   • Enhance budgeting procedures  
   • Enhance project monitoring information. | • Develop systems and processes for SNG level (provincial and local levels) that will lead to strengthened PFM at subnational level; and  
   • Strengthen SNG capacity building arrangements. | • Improve the comprehensiveness of financial reporting;  
   • Strengthen systems and improve the IT infrastructure; and  
   • Strengthen the internal control framework including the internal audit function. | • Establish arrangements to mainstream PFM capacity building; and  
   • Strengthen Citizen’s Engagement in PFM  
   • Strengthen the PEFA secretariat to coordinate implementation of the overall PFM strategy of the government. |
| **Areas of Focus**          | • Support implementation of guidelines for better filtering of projects.  
   • Pilot test the implementation of updated and revised guidelines in selected sub sectors;  
   • Explore opportunities to further enhance current guidelines by simplification, and introducing sector and scale specific guidelines.  
   • Provide continuous capacity building and handholding to build an effective pipeline of prioritized projects for targeted subsectors  
   • Update budgeting framework and develop procedures to align with the framework.  
   • Data collection activities and maintenance of a CAPEX database | • Prepare and implement a road map for an integrated approach to PFM at all 3 tiers of government, underpinned by a gap analysis.  
   • Build capacity of training institutions by (a) training of trainers; (b) developing training manuals/courses  
   • Pilot test the new PFM framework in selected SNGs (Potential areas covered in the road map include: (a) prepare/ enhance model laws on PFM; (b) revisit the initial legal framework established to support federalism and provide inputs to enhance the framework where required; (c) prepare integrated budget calendars; (d) design fund flow mechanisms; (e) prepare reporting formats (f) design internal audit arrangements; (g) prepare overall internal control framework and provide guidance to SNGs on internal controls; (h) prepare policy papers and carry out assessments of the current PFM system.)  
   • Reporting:  
     • Update NPSAS and its manual to align with the latest international standards;  
     • Train remaining ministries to prepare NPSAS based financial statements;  
     • Developing policies and procedures to improve the consolidation process; revise national accounting policies to formerly recognize NPSAS as the mandatory standards for reporting  
     • Revise ICAN curriculum to include public sector reporting aspects;  
     • Further Improvements/simplification to COA for greater alignment with GFS 2014;  
     • Support NFRS implementation in AGAs and SOEs as a first step towards prepare a Citizen’s engagement strategy |
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|            |                                        | out special purpose studies; (i) develop common set of cross cutting governance related criteria/indicators to monitor subnational governments; (j) design the grant formula; (k) design training arrangements included TOTs and training courses. | comprehensive consolidated financial statement covering all controlled entities;  
- Strengthen training capacity of ICAN to deliver NFRS training;  
- Prepare analytical framework on the 'use' of financial/management reporting;  
- **IT system:**  
  - Study PFM IT architecture and develop a road map to establish an integrated financial management information system (IFMIS);  
  - Develop an IFMIS in a phased manner and pilot test in a couple of sites;  
  - Train end users on manuals, procedures and systems;  
  - Provide ongoing technical support;  
  - Improve IT security systems;  
  - Develop IT policies and a sustainability plan;  
  - Acquire hardware and consolidate the TSA architecture across the tiers of government;  
  - Introduce reporting tools and support the use of fiscal information by decision makers and the citizens. |  
- Strengthen PEFA secretariat with required technical and project management skills, to implement their broader mandate.  
- Implement a change management plan to support PFM reforms  
- Carry out research to inform PFM policy and institution development on topics such as revenue management. |
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<td>PDO Level results indicators</td>
<td>• Simplified, updated guidelines on project screening, appraisal and prioritization implemented in pilot subsectors</td>
<td>• Reporting and budgeting guidelines developed and adopted to suit the new federal structure</td>
<td>• Annual financial statements aligned with international standards are prepared and published in a timely manner</td>
<td>• Sustainable arrangements for PFM training established</td>
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<td>Intermediate results indicators</td>
<td>• CAPEX database prepared and implemented in two pilot ministries:</td>
<td>• A road map for PFM support to the subnational governments prepared and implemented as per proposed sequence</td>
<td>• Line ministry level annual financial statements are prepared using NPSAS</td>
<td>• A citizen's engagement strategy is prepared and implemented as per proposed sequence</td>
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**Internal Controls and Audit**
- Prepare national internal control guidelines
- Prepare line ministry/sector specific internal control guidelines;
- Carry out an assessment of internal audit and develop a framework for internal audit.
- Prepare and implement internal audit standards on a pilot basis,
- Train internal auditors on the job and offer professional qualifications for internal auditors.