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Report No: PAD1417

PROJECT PAPER  
ON A  
PROPOSED GRANT  
IN THE AMOUNT OF US\$3.68 MILLION  
TO  
NEPAL

FOR PUBLIC FINANCIAL MANAGEMENT (PFM) MULTI DONOR TRUST FUND  
(MDTF) FINANCED STRENGTHENING PUBLIC FINANCIAL MANAGEMENT II  
(SPFM II) PROJECT (P154401)

July 22, 2015

Governance Global Practice  
Nepal Country Management Unit  
South Asia Region

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**CURRENCY EQUIVALENTS**

(Exchange Rate Effective)

Currency Un = Nepalese Rupee

NPR 100 = US\$1

US\$1.41 = SDR 1

**FISCAL YEAR**

July 15 – July 14

**ABBREVIATIONS AND ACRONYMS**

ASB	Accounting Standards Board
BER	Budget Execution Report
CIPFA	The Chartered Institute of Public Finance and Accountancy
CPS	Country Partnership Strategy
CSOs	Civil Society Organizations
DP	Development Partner
DTCO	District Treasury Controller Office
MDG	Millennium Development Goal
MDTF	Multi-Donor Trust Fund
FCGO	Financial Comptroller General Office
FMIS	Financial Management Information System
GAAP	Governance and Accountability Action Plan
GoN	Government of Nepal
ICAN	Institute of Chartered Accountants of Nepal
ICGFM	International Consortium of Government Financial Management
IFMIS	Integrated Financial Management Information System
IFRS	International Financial Reporting Standards
IPSAS	International Public Sector Accounting Standard
IT	Information Technology
MDTF	Multi-Donor Trust Fund
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NPSAS	Nepal Public Sector Accounting Standards
PCC	Program Coordination Committee
PDO	Project Development Objective
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
RMIS	Revenue Management Information System
SPFM	Strengthening PFM Systems
TSA	Treasury Single Account
CIMA	Chartered Institute of Management Accountants
ACCA	Association of Chartered Certified Accountants
INGAF	Institute of Government Accounting and Finance
HIES	Household integrated economic survey

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**Nepal: Strengthening Public Financial Management II (SPFM II)  
Project  
(P154401)**

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**DATA SHEET**

*Nepal*

*Nepal: Strengthening Public Financial Management II (SPFM II) ( P154401 )***SOUTH ASIA  
GGODR**

<b>Basic Information</b>			
Date:	June 25, 2015	Sectors:	Governance
Country Director:	Johannes Zutt	Themes:	Public expenditure, financial management and procurement
Sector Manager/Director:	Fily Sissoko	EA Category:	C
Project ID:	P 154401		
Instrument:	Small Grant		
Team Leader:	Manoj Jain		

Joint IFC: No

Project Implementation Period: Start Date: July 17 ,2015 End Date: July 31, 2017

<b>Project Financing Data</b>			
<input type="checkbox"/> Loan	<input checked="" type="checkbox"/> Grant	<input type="checkbox"/> Other	
<input type="checkbox"/> Credit	<input type="checkbox"/> Guarantee		

**For Loans/Credits/Others (US\$M):**

Total Project Cost :	US\$4.82	Total Bank Financing :	US\$3.68
Total Cofinancing :		Financing Gap :	Nil

<b>Financing Source</b>	<b>Amount</b>
BORROWER/RECIPIENT	1.14
IBRD	
IDA: New	
IDA: Recommitted	
Others (PFM MDTF financed project)	3.68
Financing Gap	
Total	4.82

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## I. STRATEGIC CONTEXT

### A. Country Context

1. Nepal has recorded many impressive achievements in economic and social development in the last decade and a half. The proportion of people living on less than \$1.25 a day has reduced from 53 percent in FY2003/2004 to 25 percent in FY2010/2011. There have been more remarkable achievements in reducing income poverty and improving social indicators such as life expectancy, fertility control, child mortality, literacy and enrollment rates, which in many cases exceed other countries in the region and outside as indicated by progress toward meeting the MDG goals for 2015. Sustained public spending in key priority areas has contributed to impressive social outcomes observed over the years. The country has outperformed most low-income countries on a range of social indicators. Sustained expenditures on education and health, and the partnership with the NGO community in delivery have helped to increase net primary enrollment from 64 percent in 1990 to 95.3 percent in 2013 and is on track for attaining the MDG target of 99 percent in 2015. Nepal has already attained the MDG of eliminating gender disparity in primary and secondary enrollment. Food security has improved significantly, even for the very poor.

2. Notwithstanding the achievements, the country's performance falls short of income surges in India and the East Asian economies. Although per capita growth accelerated over the past three decades, the incidence of poverty remains high at percent, as calculated by the Household integrated economic survey (HIES) data. To achieve the ambitious poverty reduction objectives and related MDG targets, growth will need to increase manifold times. This would require (i) maintaining macroeconomic stability, (ii) reorienting the role of the state to facilitate private sector led growth: and additional investments to the tune of [4-5] percent of GDP, especially in infrastructure -- power and transport. More importantly, the pursuit of a more equitable growth agenda requires improving the ability of poor people to participate more fully in the growth process, through access to better quality education, health, water, nutrition and governance.

3. The earthquakes of 25 April and 12 May 2015 have been a terrible calamity for Nepal as they affected almost half of its districts. Approximately 9,000 people lost their lives, more than 22,000 people were injured, and more than half a million houses collapsed or are damaged. The earthquake has shaken the economy with immediate losses of about 2 billion dollars bringing the combined economic effect of the disaster to a minimum of 7 billion.<sup>1</sup> The country was pursuing the next generation of economic reforms, enacting or revising several dozens of policies, acts, and regulations. Nepal was also on a path to achieving many of the Millennium Development Goals by the end of this year, including the target of halving absolute poverty. This earthquake halts this momentum – and upsets the nation's high aspirations for rapid progress. Annual economic growth this fiscal year is expected to be the lowest in eight years. The social sector with Tourism, Agriculture, financial institutions, real state etc. have all been hit hard.

4. This disaster primarily affected rural areas, with the most poor and vulnerable disproportionately impacted. At the request of the Government of Nepal, a comprehensive assessment of the damages and losses was undertaken (Post Disaster Needs Assessment) with technical assistance from development partners, as the first step towards recovery planning which helped identify recovery needs as well as help develop strategy required for implementation. This is just the beginning and a long road lays ahead. This also offers a unique opportunity to build back better a more resilient and inclusive Nepal that can continue progressing on its development pathway.

5. The role of public financial management (PFM) systems of Nepal becomes even more important in the context of this tragedy as there is even a larger need for directing appropriate

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<sup>1</sup> Nepal Earthquake 2015 Post Disaster Needs Assessment (PDNA) report

resources in an efficient, timely, transparent and accountable manner towards relief and reconstruction activities; and to help move towards the recovery path in a faster manner. As a core area for reform in developing countries, public financial management (PFM) systems support decision making on fiscal policy, strategic allocation of resources and underpin budget implementation and reporting. The importance of PFM becomes even more pronounced in a country like Nepal due to resources being limited, environment being fragile and the large task ahead of dealing with post disaster recovery.

## **B. Sector and Institutional Context**

6. Improving Governance and Accountability underpins the agenda of the Government of Nepal (GoN). Strengthening Public Financial Management (PFM) is a key element of the GoN's strategy for strengthening governance, optimizing outputs from public resources and for ensuring inclusive and broad-based development. Overall, there has been increasing demand for effective use of resources provided for development efforts in order to ensure value for money through a sound PFM system and for better results measured through technical reviews of performances. The GoN's intention of establishing a sound PFM system that will ensure transparent, efficient, economical and accountable use of budgetary resources and donor funds has resulted in several initiatives to strengthen PFM in Nepal.

7. In 2008, the GoN formed a PFM Steering Committee (chaired by the Finance Secretary) and set up a PEFA Secretariat (currently located in the Financial Comptroller General Office (FCGO) premises) to drive the reform initiatives and coordinate the PFM reform efforts. A Public Expenditure and Financial Accountability (PEFA) Assessment was carried out in 2009 to assess the performance of the country's PFM systems in comparison with internationally accepted benchmarks which formed the basis for GoN formulating a Public Financial Management Reform Program (PFMRP) Strategy, Phase I, with the objective of adopting a holistic government-wide approach to PFM reforms encompassing both the institutional and technical aspects.

8. Very recently a follow on assessment – Second PEFA report was officially launched and made public by GoN. Finalization of this report has been extensive, very consultative and has demonstrated the ownership and commitment of GoN towards this agenda. This joint process included a self-assessment prepared by Government of Nepal (nine teams formed for the purpose led by joint secretaries) which was thereafter qualitatively assessed by a World Bank team and PEFA Secretariat (Washington DC). The commitment to change and reform PFM systems and process by the Government of Nepal has produced encouraging results as evidenced in this report. Almost 60% of performance indicators have shown improvement. Among 28 performance indicators, 16 indicators improved, 10 indicators remained unchanged and only 2 indicators deteriorated (due to external factors such as non-existence of parliament during the period under review).

9. Following the finalization of PEFA II report, the GoN is also in the process of preparing a PFM Reform Action Plan Phase 2 with appropriate consultation and support from PFM MDTF and development partners (DPs). Preparation of this action plan will help sustain the ongoing PFM reforms in Nepal and promote effective and transparent public spending. The future work program of MDTF and of other Development Partners will be based on activities identified in this plan. The intended outcome of this initiative is enhanced efficiency, transparency, and integrity of public finances at the national and sub-national levels.

10. The PFMRP Strategy Phase I had two key priorities for the short term: (1) to deliver actions that yield effective results in strengthening the PFM system, and (2) to build the capacity of

the PEFA Secretariat to lead the PEFA agenda and institutionalize the reform process<sup>2</sup>. This Strategy recognized the need to first continue with the initiated reforms on improving budget and financial management systems within the executive and actions were taken to identify particular reform components in the following three years – namely implementation of Treasury Single Accounts (TSA) system, enhancing financial reporting (IPSAS based NPSAS implementation), and strengthening of PEFA Secretariat. This project embraces this Strategy and intends to build gradually on the positive momentum for reform. In December 2010 the Multi-Donor Trust Fund (MDTF) was established by the World Bank and major development partners. Currently there are seven donors to the MDTF: the European Union (EU), the UK Department for International Development (DFID), the Government of the Swiss Confederation, the Governments of Norway and Denmark, the Australian Government Department of Foreign Affairs and Trade (DFAT) and the United States Agency for International Development (USAID).

11. The MDTF has been assisting the GoN to modernize the PFM systems both through supply side (Project with Ministry of Finance to modernize payments through a Treasury Single Account; upgrade audit systems through an intervention with Auditor general; strengthening budget process for results ; and demand side (to expand civil society demand-side collaboration with the government’s supply side services on PFM accountability, transparency and inclusion) projects. In addition, it helped conduct analytics (Operational Risk assessment framework and Public Expenditure Tracking Survey) to inform the PFM reform dialogue. Further details available on Nepal MDTF PFM website ([www.mdtfpfm.org.np](http://www.mdtfpfm.org.np)).

12. The ongoing Strengthening Public Financial Management Reform (SPFM) project has been highly successful in implementing the Treasury Single Account (TSA) concept in a record time in Nepal with closure of over 13,500 bank accounts. TSA has been rolled out across all 75 districts in Nepal at least a year before the target leading to 100% coverage of the budget. Real time budgetary expenditures are now available to all stakeholders through the website of the FCGO which has significant impact on the decision making behaviors of the line managers, and has helped improve the transparency in public finances. These results are also clearly evident in the upgrade to several ratings in draft PEFA II report. Monthly budget executions reports (Ministry wise, Spending District wise, Economic Classification wise) have been strengthened and are available on a timely basis. Daily reports on aggregate budget implementation are also made available on the website and visual media (LED CTVs) located at strategic locations. Implementation for recording commitment across all 75 districts and pilots with respect to newly designed Revenue Management Information Systems (RMIS) in three large revenue receiving districts (Kathmandu, Lalitpur and Bhaktapur) have been initiated. Accounting Standards Board (ASB) successfully drafted the Nepalese Financial Reporting Standards (modeled on International Financial Reporting Standards) after an extensive consultative process. Pilots of Nepalese Public Sector Accounting Standards have been successfully completed. In view of the good progress, both the “Achievement of PDO” and “Implementation Progress” are currently rated “satisfactory”. A detailed description of the implementation progress under ongoing project SPFM is provided in Annex 5.

13. This Project Paper seeks the approval of the Country Director to provide grant in the amount of US\$3.68 million for a follow on project to the ongoing SPFM - Strengthening PFM Systems II Project (SPFM II). SPFM II<sup>3</sup> is based on the affirmative decision of the Program

<sup>2</sup> Following priorities were identified in the strategy: technical support on basic budgeting and treasury functions; outreach and consensus building on the need for PFM reforms; leveraging information technologies such as Integrated Financial Management Information Systems (IFMIS); strengthening the audit function; strengthening the parliamentary oversight function ; strengthening PFM monitoring by both State and non-State actors, and supporting the design of a sound financial management system in the context of state restructuring and transition to a possible federal system

<sup>3</sup> Till now SPFM II was being processed as an additional financing (PCN review completed on March 27, 2015). However with OPCS clarification that a small grant (less than USD 5 mn) cannot have additional financing, the team is now processing this further as a standalone follow on operation to SPFM project.

Coordination Committee (PCC) meeting of the PFM MDTF held in September, 2014 and in response to a request from the Government of Nepal (GON) received in June 2014.

14. SPFM II project will be a follow up to ongoing SPFM project and will primarily allow the government to upgrade the IT infrastructure for enhanced sustainability of the Treasury Single Account (TSA) and enhance the Financial Management Information System (FMIS) for fully implementing commitment recording and enhancing revenue management. All of these activities are important to sustain the results obtained under the ongoing project (SPFM) and therefore the follow on project continues to have the same project development objective of 'improving expenditure control and enhancing government accountability and transparency by strengthening treasury system, improving financial reporting and building up PFM Capacity'.

15. SPFM II would: (i) continue to support the ongoing SPFM activities, while assisting GON in closing the financing gap in sustaining the TSA infrastructure; (ii) consolidate and sustain gains in TSA implementation, and (iii) enhance the Financial Management Information System (FMIS) for fully implementing commitment recording and enhancing revenue management. SPFM II will not need a new design as it will continue with the same PDO and selected project components/activities which are required. However, this follow-on project will entail some adjustments in the Results Framework and the Governance and Accountability Action Plan (GAAP).

16. The PCN review pointed out the need to quickly resurrect the payment function in earthquake affected districts given the recent disaster after the earthquakes in Nepal on April 25, 2015 and May 12, 2015. It was agreed that this follow on project will also include an activity (under component 1) to identify necessary measures that are required to resurrect the TSA infrastructure in the affected District Treasury Controller Offices (DTCOs). This will allow ensuring relief/reconstruction efforts to take place on a seamless basis in the public sector. In addition to the follow on project, GoN requested for extension of closing date and reallocation of categories for ongoing SPFM which has recently been completed<sup>4</sup>.

### **C. Lessons Learned and their Reflection in the Project Design**

17. The MDTF financed projects build on lessons learned in designing and implementing projects in Nepal and elsewhere. In particular, lessons have been drawn from PFM projects supported in Nepal. The specific lessons learnt and incorporated into the overall MDFT financed PFM program and specifically in this project are:

- a. *Need for a strong country led PFM reform program.* Given the experience of PFM reforms in public sector in various countries, it is essential that PFM reforms be country led and any support from external development partners should build support into this reform. Nepal has set a good example leading the PFM reform program since the Country Financial Accountability Assessment (CFAA), Country Procurement Assessment Review (CPAR) and PEFA assessments. A PFM strategy Phase I was developed by GoN after the first PEFA which is now being updated. The proposed project aligns with the above strategy.
- b. *Need for a strong coordination mechanism both at GoN and at DP level:* Given the essential requirement of stakeholder support during PFM reform implementation, there is a need for building a strong coordination mechanism. In Nepal, this mechanism has been set up over the last few years with an effective functioning National PFM Steering Committee and PEFA Secretariat. They regularly meet with government and other stakeholders

<sup>4</sup>Till now SPFM II was being processed as an additional financing (PCN review completed on March 27, 2015) and the restructuring of SPFM was part of that package. However with OPCS clarification that a small grant (less than USD 5 mn) cannot have additional financing, the team is now processing SPFM II as a stand-alone follow on operation to SPFM project; and processing a restructuring the SPFM separately..

(including line departments and the Office of the Auditor General) to discuss PFM challenges and to streamline the coordination. There is also a need for strong donor coordination not only among the MDTF donors but with all other development partners at large. The successful PFM TWG meeting which is co-chaired by the WB and DFID where knowledge and information is exchanged and discussed between partners on overall PFM development and challenges is shaping up well to upscale the policy level dialogue in this regard.

- c. *Sustaining technical support on basic budgeting and treasury functions as a strong base for future PFM reforms in the sector:* Experiences from across various PFM programs in other countries have stressed the need to have basic processes set right before beginning an ambitious journey of reforming the PFM systems. GoN's strategy which emphasized on initiating PFM reforms in the basic budget implementation and treasury management functions, were implemented through SPFM, and now form a fulcrum for designing and implementing the next phase of reforms (revenue management and commitment control) through SPFM II.
- d. *Need to support outreach for consensus building on the need for PFM reforms among government and civil society stakeholders:* Working on the demand side of PFM in parallel is equally important to create demands for various supply side system improvements. A separate project on the demand side of PFM was implemented and a follow on project has recently been approved; which has ensured a holistic approach to improving PFM systems. Various awareness building and communication programs are integrated into the project which links well with demand side.
- e. *Need for strong analytical and research support:* As PFM reform and implementation gathers speed with preparation of PFM reform Strategy Phase 2, there is a need to analyze emerging issues and offer practical solutions. The project continues to support an analytical and research component at the PEFA Secretariat through building up necessary skills and staffing.
- f. *Need for Institutional capacity building:* Accountability institutions often lack resources and skills required to sustain the institutional reform. The project will provide training and skill building to a range of staff working in PFM and accountability institutions to respond to rapidly changing demands and expectations. Improved management practices can help improve decision-making, planning and budgeting, treasury management to produce better outcomes.

#### **D. Contribution to Higher Level Objectives**

18. The proposed grant under SPFM II is fully consistent with the government's development strategy presented in the GON's *Approach Paper to the Thirteenth Plan (2013-16)*, directly supporting the following strategies: enhancing good governance in public and other sectors and identifies "Strengthening Governance and Accountability" as a cross cutting agenda. The proposed grant will also improve performance of the public financial management systems of GoN through a shift in focus to institutions and institutional building especially through training and capacity building. It will also continue to contribute to the fiscal consolidation agenda of the GoN by enhancing efficiency of public expenditures.

19. The project is fully consistent with the Bank's Country Partnership Strategy for Nepal (CPS: FY2014-2018) which identifies strengthening institutions of governance as a key plank of the World Bank's engagement in Nepal. SPFM II would also continue to support the cross-cutting objective of improving effectiveness, efficiency and accountability of public expenditure. This Project is also very closely aligned to MDTF DPs' priorities and is therefore considered very important for the PFM MDTF agenda.

## II. PROJECT DEVELOPMENT OBJECTIVES

### a. Project Development Objective

20. The Project Development Objective (PDO) of SPFM II would continue to remain as that of SPFM, that is, “to improve expenditure control and enhance government accountability and transparency by strengthening the treasury system, improving financial reporting and building PFM capacity”. The key project indicators and end-of-project targets are detailed in Annex 1.

### b. Project Beneficiaries

21. The project is expected to improve controls in public expenditure management and budget monitoring and financial reporting of Government of Nepal. In addition, it will continue strengthen the cash/revenue management procedures and practices during budget implementation leading to better fiscal controls. The direct beneficiaries of the project are approximately 7,500 public servants who are currently engaged in budget management and execution across the entire government. These staff will get access to orientation training on new enhanced systems being rolled out across the government, short-term skills training, exposure to international best practices and opportunities for undertaking research in PFM areas. Indirectly, this project will benefit the government and public at large in Nepal, as it cuts across sectoral boundaries and strengthens accountability and service delivery to citizens through enhanced fiscal discipline, improved prioritization of expenditures, and increased efficiency and effectiveness.

### c. PDO Level Results Indicator

22. The PDO will be measured through the following outcome indicators.

Project Development Objectives	Project Outcome Indicators	Use of Project Outcome Indicators
To improve expenditure control and enhance government accountability and transparency by strengthening treasury system, improving financial reporting and building up PFM capacity.	Percentage of overall budget executed through the DTCOs where the TSA system has been implemented	Improved Budget management, real time monitoring and enhanced implementation. Improvement in cash management practices. Consolidation of bank accounts ploughs back unutilized money from spending units in treasury, provides more fiscal space and leads to better cash management.
	Budget Execution Reports and Financial Statements produced on a real time basis by the TSA system in the district and central systems.	Real time budget availability checks at DTCOs eliminate unauthorized expenditures and therefore lead to better fiscal controls. Real time information on budget implementation assists line managers to take informed decisions.
	Consolidated financial statements for Pilot Ministries prepared in accordance with Part 1, Cash IPSAS	Enhanced transparency and qualitative financial reporting leads to better managerial decision making and allocative efficiency.
	Numbers of research studies into high priority PFM areas completed and disseminated; and PFM capacity of staff built	Local research and analysis help decision makers in taking practical actions to tackle issues and challenges related to public financial management. PFM accreditation courses designed and courses initiated

	Improved Sustainability of the TSA system	System based monitoring of IT networks and devices - network enhancement will enable remote monitoring and auto switching with better system availability. IT Strategy, organization structure and detailed plan prepared and implemented - which will FCGO to discharge its functions effectively and efficiently. IT audits will help make environment and landscape more secure and identify issues that need resolution.
	Improved quality of the in-year and end-of-the-year financial statements	Roll out of Revenue Management Information System (RMIS) at districts and paying centers will help faster accurate and reconciled reports on revenue side.

### III. PROJECT DESCRIPTION

#### a. Project Financing

23. This follow on project will continue to be financed from PFM Multi Donor Trust Fund (MDTF) which was set up for PFM activities in Nepal<sup>5</sup>. The World Bank is taking the lead in coordinating donor support for the PFM agenda, in view of its experience in designing and supporting implementation of PFM reforms and working with key institutions of accountability. This recipient executed grant will be supported, on a parallel basis, by Bank executed non-lending technical assistance which will provide critical expertise in support of the implementation of these reforms.

#### b. Project Components

24. The project cost and grant financing of SPFM II through MDTF is summarized in Table below :

(US  
\$)

Component	Description	Project Cost	MDTF Contribution
1 (a)	<i>Enhancing and Sustaining the Treasury Single Account (TSA) System (@75%)</i>	3,840,000	2,880,000
1(b)	<i>Replacement of treasury infrastructure at affected districts (@75%)</i>	240,000	180,000
2	<i>Strengthening accounting and reporting practices in public sector (@75%)</i>	160,000	120,000
3	<i>Supporting the capacity building of the PEFA Secretariat (@85%)</i>	588,235	500,000
	<b>Total</b>	<b>4,838,235</b>	<b>3,680,000</b>

25. **Component 1 (a) : Enhancing and Sustaining the Treasury Single Account (TSA) System (USD 2,880,000):** The original SPFM under this component involved: (i) implementation of the Treasury Single Account for efficient cash management; (ii) roll-out of FMIS (Financial Management Information System) for enhanced budget compliance during expenditure execution and payment process; (iii) further enhancement of the FMIS to support commitment accounting and improved financial reporting - aimed at strengthened expenditure controls and enhanced transparency. These were considered to be the foundational elements to provide a basic platform before beginning an ambitious journey of PFM reforms in Nepal. Emphasis was on implementing expenditure Treasury Single Account, supported by FMIS roll-out in a phased manner across Nepal. In this regard, expenditure payments of ministries at Kathmandu and the 75 districts were centralized at the treasury offices, and processed through the FMIS, enabling the government close about 13,500 bank accounts of these ministries, thus eliminating idle cash

<sup>5</sup> Please refer to the approved PFM MDTF Concept Note dated December 3, 2010

balances in these accounts. However, this iteration did not involve full implementation of two major activities of the original scope: revenue TSA and commitment controls.

26. Currently, DTCO receives expenditure account statements from the respective bank and subsequently carries out expenditure account bank reconciliation almost on a daily basis. However, the situation with revenue reporting is not the same. The banks do not report revenue collections to the DTCOs in a timely manner, which leads to inaccurate information on government's aggregate cash position in the TSA. Besides, the commitment controls is not being practiced currently. The line ministries issue purchase-orders and contracts to the suppliers, without recording them in the system as commitments. Due to this, the government does not have information on its aggregate commitments that could allow appropriate cash planning to ensure commitments are paid in a timely manner to avoid any build-up of potential payment arrears.

27. The government plans to complete these reforms (revenue TSA and commitment controls) by enhancing the FMIS through SPFM II and consolidate the TSA rollout. Besides system roll-out, the major proceeds of the SPFM II will flow towards up gradation of the IT infrastructure to enhance sustainability, security and efficiency of the system. This will include networking equipment, power back-up equipment and IT devices (including desktops and printers).

28. WB team has reviewed and has done on-site evaluation of IT infrastructure upgrades requested under proposed SPFM II. The upgrade proposals have been based on the assessments by third party experts/consultants in the field, and are primarily aimed to help the government upgrade its IT infrastructure and power-back-up arrangements comprehensively. The sustainability of current IT infrastructure at FCGO is a major challenge with old/outdated, end-of-life/support for hardware and software. The follow on financing through SPFM II will ensure enough room for projected growth, more applications and data for next three to four years and will also include maintenance. Risk associated with continued IT support from the consultants is high as it is not sustainable. MOF and Cabinet has recently approved creation of senior level IT positions (Deputy FCG level) and consultant positions<sup>6</sup>. Process has been initiated to hire requisite staff for these positions.

29. Activities to be financed under this activity include: (i) roll-out of commitment module; (ii) roll-out of revenue recording module; (iii) roll-out of cash management and electronic bank reconciliation; (iv) training and capacity building; (v) hardware and other IT and power infrastructure; (vi) consulting services to support the above activities; (vii) change management workshops.

30. ***Component 1 (b) : Replacement of treasury infrastructure at earthquake affected districts (USD 180,000):*** In response to the needs of the recent earthquake in Nepal on April 25, 2015 and damages caused to treasury infrastructure in affected districts, GoN has requested Bank support to help quickly resurrect the payment function in these districts. As per reports made available, 30 districts have been affected of which 14 districts have been badly affected. Of these, three DTCOs (Sindhupalchok, Rasuwa and Nuwakot) treasury buildings have collapsed. There have been damages to computer equipment, power backup system, furniture and vehicles at all of the affected districts. FCGO had issued the instructions, on the day after the earthquake, to all DTCOs to use manual system for issuing cheques wherever computer system/network was not available. It is remarkable to note that none of the DTCOs had to use manual system. This was

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<sup>6</sup>Bank has been informed that following IT positions have been approved by Cabinet (for FCGO) in a meeting held in January, 2015: (a) Senior Computer Engineer - IT Director. (equivalent to DFCG position): 1 position, (b) Computer Engineers (1 position for hardware + 1 position for software), (c) Computer assistant/ Technical level- 2 positions. Given the market conditions and skills required, the team will also evaluate if it is more effective to hire a firm for position of IT consultants as identified. This will be indicated in the procurement plan.

possible due to a web based TSA, fall back network access via Nepal Telecom and using bare minimum computer equipment in make shift locations, tents, rented premises and borrowed equipment from Nepal Army.

31. To allow these DTCOs to undertake regular operations, FCGO has made a request of funding to finance furniture, computer equipment, power backup system, house rents and repairs & maintenance. This would not include any civil works/construction. Civil works will be separately financed after a strategy emerges after damage assessment is completed by the Government of Nepal and a financing strategy is agreed. These damages were primarily self-assessed by each DTCO and verified on sample basis by FCGO staff. An allocation of USD 180,000 is made to this activity which will be adjusted during implementation as further details emerge.

32. ***Component 2: Strengthening accounting and reporting practices in public sector (USD 120,000)***: As stated earlier, the NPSAS compliant financial statements for pilots conducted in two ministries (Ministry of Physical Infrastructure and Transport (MoPIT) and Ministry of women, children and social welfare (MoWCS) have been completed and certified by ICGFM under the current project. This was led and coordinated by the accounting unit in the FCGO. Thereafter, a high level stakeholder workshop was organized to review the results of the NPSAS pilots, specifically to review the costs and benefits of applying NPSAS, and to reach consensus on a recommended roadmap for improving public sector accounting and reporting in Nepal.

33. To demonstrate ownership, these two pilot departments have initiated the process of preparing NPSAS compliant financial statement for latest years and are getting it audited by the Office of Auditor General. This will help complete the pilot and help establish credence in these financial statements. This will also help the stakeholders design a roadmap for the full-fledged implementation of NPSAS across line ministries under SPFM II.

34. Under SPFM II, GoN is planning on scaling up the roll out of NPSAS across all ministries in a phase wise manner (5 in FY 16 and another 5 in FY 17). FCGO will lead this activity in coordination with line ministries and other key stakeholders. This activity will require consultancy support and adequate training/capacity building activities will be undertaken while implementing at the level of line ministries. Trainings would need to be conducted to create awareness among stakeholders. A software utility will also need to be developed to analyze TSA data and prepare financial statements based on NPSAS. A practical rollout plan will need to be drawn up, which will take into account lessons learned from the previous pilot.

35. This component will fund the consultancy costs, the seminars/workshops, development of training modules and materials, associated costs of the accounting unit in FCGO and other related costs.

36. ***Component 3: Supporting the capacity building of the PEFA Secretariat (USD 500,000)***: The PEFA Secretariat has made some remarkable achievements under this component. There is a need to continue the outreach, awareness, communication, training, research and capacity building activities to support PFM reform in Nepal. In addition, SPFM II will also help support build national PFM training and capacity building by collaborating with a local academic pioneer institution (like Nepal Administrative Staff College) and working on developing a PFM core curriculum for public sector practitioners.

37. ***Building In-country capacity for PFM Training Program***: FCGO completed a training needs assessment earlier. Based on this assessment, a need has been expressed for designing and conducting accredited courses on PFM in Nepal. The objective of this training activity would be to collaborate with a national academic institution (like Nepal Administrative Staff College) and an international professional institute (such as CIPFA, CIMA, ACCA and INGAF ) on a pilot basis, in order to enhance knowledge on PFM among public officials. At present, an intense dialogue is taking place to identify a suitable international professional

institute that will be able to offer structured PFM courses matching the needs of GoN and provide accreditation through a certificate/diploma. This activity will be a first step as a pilot and lessons learned from this pilot will be assimilated to help design a PFM training project later on as part of PFM Reform Strategy Phase 2. An MoU shall be signed between PEFA Secretariat, Nepal Administrative Staff College and the International Professional Institute by September, 2015, which will identify the national requirements to design the curriculum. For this purpose, a committee at PEFA Secretariat will be formed that will help focus the efforts. The international professional institute will provide trainers along with course materials while the national academic institute will provide classrooms, academic infrastructure and also incorporate elements of these classes to regular courses. This project will fund faculty and the initial fees for the selected long term courses. It is expected that the course offerings will begin by December 2015 with at least two round completed before the end of the project.

38. The PEFA Secretariat has been conducting workshops, orientations and interaction programs on PFM at PIU level.<sup>7</sup> This will continue under SPFM II and the target is to cover 10 PIUs in the first year and 16 PIUs in the second year. Based on proposals received from DPIUs, the PEFA secretariat will provide resources to DPIUs to conduct PFM related activities such as radio programs, orientations and awareness on PFM. Under SPFM II, the PEFA Secretariat aims to cover 25 DPIUs in each year. The PEFA secretariat has been delivering regional (5 development regions) level trainings across the country. This activity will be further enhanced and scaled up at the regional level under SPFM II. National level PFM trainings will be based on feedbacks from the previous trainings. Under SPFM II, the PEFA Secretariat will continue to publish newsletters and journals every year. These materials will be disseminated through the PEFA website, forums and distributed to ministries, libraries and other stakeholders. The PEFA Secretariat will continue to hire consultants to conduct research studies under SPFM II. These will include general and in-depth research studies in important and strategic areas. These topics will be identified based on the findings from the second PEFA assessment.

39. A detailed project description is provided in Annex 2.

#### IV. IMPLEMENTATION

##### a. Institutional arrangements

40. Following the PEFA I assessment, GoN formed a National level PFM Steering Committee which is chaired by the Finance Secretary and comprises representatives of the Ministry of Finance (MOF), the National Planning Commission (NPC), the Office of the Auditor General (OAG), the Financial Comptroller General Office (FCGO) with a provision to invite other ministries or departments or agencies based on the themes of discussions. Currently the committee comprises of 14 members (including five from line departments and a member each from Transparency International Nepal and the Federation of Nepal Chambers of Commerce and Industries). The overall objective of the committee is to provide strategic direction in public financial management. The PFM Steering Committee established a PEFA Secretariat in 2008 is currently headed by the Joint Financial Comptroller General of FCGO, who also serves as the Member Secretary of the PFM Steering Committee. Currently, the Secretariat has five full time staff. A PEFA Working Committee has also been created to support implementation of the decisions of the Steering Committee and to support functioning of the Secretariat. The Working Committee is chaired by the PEFA Coordinator and with representatives from the MOF, NPC, OAG and several line departments (11 members in total).

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<sup>7</sup> Composition of PIU: Planning Chief (Coordinator), Planning Section (1), Finance Section (Member Secretary), Admin section (1) and Monitoring and Evaluation (1). Composition of DPIU: DTCCO chief (Coordinator), DAO (officer), DDC planning officer, technical officer, private sector representative and representative from CSOs and DTCCO nominated accounting staff.

41. PEFA Implementation Units have currently been established in 17 line Ministries that help coordinate with the PEFA Secretariat in implementing the PEFA/PFM Action Plan. The Coordinator of the PEFA Secretariat serves as the primary focal point for monitoring and reporting the implementation progress of PFM reforms. A dedicated budget head (fully operable by the PEFA Secretariat) is assigned for the PFM reform program in the government's budget and the same budget head will be used to fund the program to be financed under this project. It is envisaged that PEFA Secretariat will prepare a monthly update with regard to status of the work plans/actions. The National level PFM Steering Committee chaired by the Finance Secretary will review the implementation progress on a quarterly basis.

42. **Implementation arrangements under SPFM II** will remain same as that of SPFM project with activities fully aligned with the existing government system. PEFA Secretariat will continue to serve as the coordinator for the project with monitoring and reporting the implementation progress of this project and the overall PFM reform program of GoN. Component 1 will continued to be carried out by TSA unit/Treasury Section, separately established within FCGO, which is coordinated by a Joint Financial Comptroller General. The Accounts Strengthening Section of the FCGO will continue to be responsible for implementing Component 2 and the PEFA Secretariat will remain responsible for implementation of PFM related capacity building program under Component 3. The PFM Steering Committee will provide overall strategic guidance and oversight. The PEFA secretariat under overall guidance of the PFM Steering Committee will oversee the implementation of the project.

#### b. Key Risks

43. **Standardized Operating Risk rating Tool (SORT):** The project risks are summarized in the table below in line with the newly adopted SORT. Compared to the ongoing project, the risks associated with SPFM II are not expected to change in any significant manner. In fact, given the track record of SPFM and successes achieved, associated risks are perceived to be lower. However, this risk needs to be now associated with the recent earthquake and the possible changes that will take place in the public sector arena. Possible constraint for staff time at senior or middle level (to deal with emergency related issues) is seen as an emerging risk, which will need to be mitigated suitably.

44. The overall SORT risk is assessed as moderate.

<b>Risk Category</b>	<b>Rating (H, S, M or L)</b>
1. Political and governance	Substantial
2. Macroeconomic	Moderate
3. Sector strategies and policies	Moderate
4. Technical design of project or program	Moderate
5. Institutional capacity for implementation and sustainability	Moderate
6. Fiduciary	Moderate
7. Environment and social	Low
8. Stakeholders	Low
<b>Overall</b>	<b>Moderate</b>

45. The main risks to achieving the intended results are political and governance risks. Risks related to the fiduciary environment and institutional capacity for implementation and sustainability are considered moderate due to evident results and commitment displayed under the on-going project.

46. The political and governance risk is substantial for a number of reasons, including the high risk of frequent turnover of civil service staff. For example, during the implementation of the

Strengthening PFM Project, there has been a number of changes of the Financial Comptroller General and the PEFA Secretariat Coordinator. The GAAP presented in Annex 4 which includes risk mitigation measures to address issues related to potential funds misuse, and transparency.

### c. Results Monitoring and Evaluation

47. **M&E Arrangements** under the current SPFM will continue under SPFM II. PEFA Secretariat will monitor and report to PFM MDTF - all activities of the project being executed by institutions and agencies under their purview. All monitoring data and reports from across the various agencies under this project will be submitted to the PFM MDTF through the PEFA Secretariat. The PEFA Secretariat will be responsible for: (a) routine monitoring, (b) monitoring through regular/periodic reviews, and, (c) overall project evaluation and implementation completion review at project close.

### d. Changes in SPFM II

48. As described earlier, SPFM II is primarily in the nature of additional financing to the ongoing SPFM (but as WB rules for small grants do not suggest for additional financing, a separate follow on project is being prepared) and it does not entail any changes to PDO project description/components, eligible expenditure items, implementation and disbursement arrangements, guidelines or other associated instruments. The main changes under SPFM II are :

- a) Dropping of one sub-component related to promulgation of Nepal Financial Reporting Standards (NFRS) by Accounting Standards Board (ASB) as that has been fully achieved under the on-going SPFM I and consequent changes in implementation arrangements (no implementation role foreseen for ASB).
- b) One new activity has been included such as building in-country capacity for PFM Training Program which does not however result in change of objective
- c) The Results Framework (Annex 1) has been slightly aligned to account for the achievements made under SPFM project till date, enhanced focus on important activities such as commitment control and revenue management going forward and to measure results from investments made to sustain and consolidate the TSA IT Infrastructure.
- d) The GAAP<sup>8</sup> (Annex 4) has been updated to mitigate program implementation and fiduciary risks as assessed currently. The key additions to the updated GAAP include the learning obtained till date and proposed refinements in activities.
- e) The closing date of the existing project – SPFM (P125770) has been extended to June 30, 2016 and SPFM II (P154401) is proposed to close in June 30, 2017 to allow for full two years of implementation.

## V. APPRAISAL SUMMARY

49. **Economic feasibility:** The successful implementation of TSA concept under SPFM has already started to result in savings in forms of lower interest costs, better, timely and qualitatively improved financial reporting and started influencing decision making of the line managers who manage budgets. Around 13,500 bank accounts have been closed so far under the project which have led to lower borrowing and better cash management. The internal borrowings of GoN has gone down from 42.55 bn NPR in 2010-11 to 19.98 bn NPR in 2013-14, partly a result of the implementation of the TSA, better cash forecasting and better cash management. It is conservatively estimated that an annual interest saving of roughly 112 mn NPR is accruing to GoN on account of consolidation of cash balances through TSA concept.

50. SPFM II would continue along the same path by supporting and consolidating the TSA rollout with major emphasis on enhancements such as commitment control and revenue

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<sup>8</sup>The updated GAAP will be applicable to both the Fixed and the Variable Parts of the Grant.

management. Management reports resulting from implementation of commitment control concept is expected to lead to better internal controls, better budget management by managers and re-prioritization towards more productive expenditures. Improvement in Bank reconciliations with automation of revenue management modules and enhancement of control framework will lead to faster collection of revenue (reducing the lead time for reconciliation) and lower the possible leakages. Advisory support and investments envisaged under the project aim at improving performance of the key government institutions in implementing public financial management, execution, accounting, internal controls as well as human resource management tasks. Therefore the return of investments under the project will be to a larger extent in form, of better performing public institutions capable of employing financial and human resources in an effective, transparent and accountable way.

51. **Technical feasibility:** No new components are envisaged under SPFM II and hence continues to remain technically feasible as demonstrated by results obtained from implementation of the ongoing project. Some refinements in terms of implementation of activities and sequencing strategy will take place in order to learn from experiences and they have been assessed to be technically feasible as mentioned in Annex 2.

52. The main rationale behind SPFM II is to provide support to GON in maintaining the implementation progress of SPFM to enhance the sustainability. SPFM II will allow the government to upgrade the IT infrastructure for enhanced sustainability, security and efficiency of the Treasury Single Account (TSA) thus enhancing the Financial Management Information System (FMIS) for fully implementing commitment recording and further improving revenue management; all of which activities are important to achieve the project development objective.

53. **Financial management and Disbursement arrangements** remain unchanged from SPFM. The current financial management rating is “Satisfactory”. The implementing agency is maintaining financial management system as per the government requirements and no changes are suggested to the current Financial Management systems and processes. The ongoing review of the financial records reveals that the procedures in place are considered adequate to ensure that the fiduciary risk is minimized. There are no outstanding implementation progress reports (IPRs) and the audit reports. The disbursement will continue to be report-based using the existing reporting formats. The intended funds flow and Designated Account arrangements will remain the same as in the original project. Detailed Financial Management arrangements are provided in Annex 6.

54. **Procurement arrangements** will also remain same as that of the original project. The TSA unit in conjunction with the IT unit will conduct the procurement of the items under this follow on project. The Accounts Strengthening Section of the FCGO and the PEFA Secretariat will remain responsible for procurement under component 2 and 3 respectively. A procurement plan for existing project with one year extension and for SPFM II has been prepared and will be finalized before project negotiations. The Procurement Plan once finalized will be made available in the Project’s database and in the Bank’s external website. The Procurement Plan will be updated annually or as required to reflect the actual project implementation needs and improvements in institutional capacity. Detailed procurement arrangements are in Annex 7.

55. **Social and Environmental Safeguards:** Since there will not be any safeguards issues, existing legal covenants would continue to apply under SPFM II.

56. **Sustainability:** The key elements for sustainability of project activities are ownership, staffing for implementation and consensus building amongst stakeholders. GoN’s demonstration of leading the PEFA assessments (both times) and preparing the PFMRP Strategy, completing the TSA implementation one year ahead of time, piloting IPSAS in two line ministries, promulgating NFRSs in line with IFRSs is manifestation of the government’s full commitment and ownership to the PFM reform agenda that needs to be supported and sustained. Support to key activities consistent with the GoN’s Strategy will have a permanent impact on the PFM sector in Nepal. Institutional, managerial, administrative and technical capacity building of Line Ministries and

Departments and key agencies such as the FCGO and PEFA Secretariat will benefit both the system and the general public in the medium to long term. Retention of staff and enhancing skills in key institutions such as FCGO and PEFA Secretariat has been and will continue to remain a key to success of the project and overall PFM program. Raising awareness about PFM issues amongst stakeholders in order to keep them interested and motivated to take up challenges and demonstrating linkage of PFM reform with development agenda by PEFA Secretariat has worked – and will need to continue to ensure success to continuing PFM reforms in Nepal.

## ANNEX 1: RESULTS FRAMEWORK AND MONITORING

Project Development Objective	Project Outcome Indicators	Use of Project Information
<b><i>PDO: To improve expenditure control and enhance government accountability and transparency by strengthening treasury system, financial reporting and PFM capacity.</i></b>	<ul style="list-style-type: none"> <li>• Percentage of overall budget executed through the DTCOs where the TSA system has been implemented</li> <li>• Budget Execution Reports and Financial Statements produced on a real time basis by the TSA system in the district and central systems.</li> <li>• Consolidated financial statements for Pilot Ministries prepared in accordance with Part 1, Cash IPSAS</li> <li>• Numbers of research studies into high priority PFM areas completed and disseminated</li> <li>• Improved Sustainability of the TSA system (new)</li> <li>• Improved quality of the in-year and end-of-the-year financial statements (new)</li> </ul>	Indicates along with the intermediate outcomes and output indicators whether the project is on track in the achievement of the PDO.
<b>Intermediate Outcomes</b>	<b>Results Monitoring Indicators</b>	<b>Use of Monitoring Indicator</b>
<b>Component 1: Implementation of Treasury Single Account (TSA) System</b>		
Component 1:	<ul style="list-style-type: none"> <li>• Number of DTCOs/districts where TSA implemented; Percentage of overall budget executed through the DTCOs where the TSA system has been implemented</li> <li>• Number of Spending Unit (SU) Bank Accounts Closed;</li> <li>• Implementation of commitment controls in the budgetary entities of GoN (within the piloting ministries)</li> <li>• Number of FCGO, line department and DTCO staff trained ;</li> <li>• Roll out of Revenue Management Information System (RMIS) at districts and paying centers.</li> <li>• Online access of real time budget and financial information to line departments</li> <li>• System based monitoring of IT networks and devices</li> <li>• IT Strategy, organization structure and detailed plan prepared and implemented</li> <li>• Conduct of IT/Functional Audit in FCGO</li> </ul>	Indicates the extent to which TSA system has been implemented and real time budget controls have been strengthened for enhancing fiscal control and expenditure efficiency
<b>Component 2: Strengthening accounting and reporting practices in public and private sector</b>		
Component 2:	<ul style="list-style-type: none"> <li>• Preparation of consolidated financial statements for a number of line departments in accordance with Part 1, Cash IPSAS</li> <li>• Number of GoN finance and accounts staff trained in application of Cash based IPSAS</li> </ul>	Indicates the extent to which accounting and reporting practices have been strengthened in the core public sector in Government of Nepal
<b>Component 3: Supporting the Capacity Building of the PEFA Secretariat</b>		

Component 3:	<ul style="list-style-type: none"> <li>• Number of GoN Employees enrolled /completed in Diploma/Certificate Courses in local accredited PFM academic Institution</li> <li>• Number of National level PPFM Steering committee meetings supported during the project period</li> <li>• Number of high impact research studies completed and disseminated</li> <li>• Carried out repeat PEFA assessment and prepared PFM reform strategy Phase II</li> <li>• Number of seminars &amp; workshops conducted for raising PFM awareness</li> <li>• PFM accreditation courses designed and courses initiated (incl signing of MoU between the PEFA Secretariat, International PFM Institution and local academic Institution)</li> </ul>	Indicates the extent to which (i) PFM reforms have been initiated as per PFMRP strategy of GoN, (ii) PFM reforms have been mainstreamed in the GoN, and (iii) PFM skills and capacity is being built
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### Arrangements for Results Monitoring

PDO Level Results Indicators*	Unit of Measure	As at Oct, 2010 (SPFM baseline)	Achievement as of June 2015 (*)	Cumulative Target Values**						Frequency	Data Source/ Methodology	Responsibility for Data Collection	Description (Indicator, definition etc.)
				YR 1	YR 2	YR3	YR4	YR5 (SPFM II) June 2016	YR6 (SPFM II) June 2017				
Percentage of overall budget executed through the DTCOs where the TSA system has been implemented	% of exp.	7	98	35	55	85	98	99	100	Annual	Data from TSA system	Project Institutions – FCGO	Indicates real time budget controls in these districts
Budget Execution Reports and Financial Statements produced by the TSA system on a real time basis	No. of Districts	Nil	75	32	52	65	75	75	75	Annual	Data from TSA System	Project Institutions- FCGO	Indicates mainstreaming of TSA system
Preparation of consolidated financial statements for PILOT Ministries in accordance with Part 1, Cash IPSAS ;	No.	Nil	2	-	1	1	2	7	12	Annual	FCGO	FCGO	Indicates improved financial reporting practices
Numbers of research studies into high priority PFM areas completed and disseminated	No.	0		1	2	4	5	8	10	Annual	Institutional records	PEFA Secretariat	Indicates research and analysis to support PFM reforms
<i>Number of DTCOs/districts where TSA implemented</i>	No.	8	75	38	60	75	75	75	75	Six Month	Admin Data	FCGO	Indicates rollout of TSA
<i>Number of Spending Unit (SU) Bank Accounts Closed</i>	No.	1300	13500	7000	10000	12000	13500	13850	14000	Six Monthly	Admin Data	FCGO	Indicates consolidation of bank balances

<i>Number of FCGO , line department and DTCO staff trained or oriented; and still deployed to perform the functions envisaged</i>	No.	600	5500	3000	5000	5500	5500	7300	7600	Six Monthly	Admin Data	FCGO	Indicates improvement in skills
<i>Number of master trainers trained (TSA and IPSAS and working as trainers under the project</i>	No.	0	40	30	35	40	40	50	50	Six Monthly	Admin Data; Interviews	Secretariat	Indicates improvement in TSA implementation and consolidation
<i>Software redeveloped after removing bugs as reported in current software;</i>	-			Initiated and Tested	Piloted	Partially Functional	Functional	Functional	Functional	Six Monthly	Admin Data	FCGO ; Secretariat	Indicates improved functionality of TSA system
<i>New features added in software such as commitment recording</i>	-		Pilots	-	-	Designed	Pilots	Partial impl.	Full Impl.	Six Monthly	Admin Data	FCGO	Indicates improved functionality of TSA system
<i>Roll out of Revenue Management Information System (RMIS) at districts and paying centres</i>	No. of districts	Nil	Pilots initiated				Pilots initiated	5 districts	15 districts	Six Monthly	n Data	FCGO	RMIS will help faster accurate and reconciled reports on revenue side.
<i>Online access of real time budget and financial information to line departments</i>	No of depts	Nil	1deptt				1 dept.	5 depts	10 depts	Six Monthly	n Data	FCGO	Online access will help improve the decision making at line departments
<i>System based monitoring of IT networks and devices</i>	NA							Under impl.	Full impl.	Six Monthly	n Data	FCGO	Network enhancement will enable remote monitoring and auto switching with better system availability

<i>IT Strategy, organization structure and detailed plan prepared and implemented</i>	-	-	-	-	-	-	-	Under prep.	Implemented	Six Monthly	h Data	FCGO	FCGO needs to have a proper resourced IT organization to discharge its functions effectively and efficiently
<i>Conduct of IT/Functional Audit in FCGO</i>	Third party audits	No audits						Functional audit done	Full IT audit done	Six Monthly	h Data	FCGO	IT audits will help make environment and landscape more secure and identify issues that need resolution.
<i>Implementation of commitment controls in the budgetary entities of GoN</i>	-		-		Tested in a few entities	Designed	Piloted	Implementation initiated	Fully Implemented	Six Monthly	Admin Data	FCGO Secretariat	Commitment information will lead to better decision making at line managers level
<i>Number of GoN finance and accounts staff trained in application of Cash based IPSAS and still deployed to perform the functions envisaged</i>	No.		0	-	-	-	40	80	120	Six Monthly	Admin Data	PEFA Secretariat : FCGO	
<i>PFM accreditation courses designed and courses initiated</i>			None					Signing of MOU; Initiation of course design	Courses Started; two offerings completed	Six Monthly	Admin Data	PEFA Secretariat : FCGO	Design and Rollout of PFM training curriculum in an academic institution will create sustainable human resource capacity.
<i>Number of GoN Employees enrolled /completed in Diploma/Certificate Courses in local accredited PFM academic Institution</i>	No.	Nil	Nil	-	-	-	-	15	30	Six Monthly	Admin Data	PEFA Secretariat : FCGO	Design and Rollout of PFM training curriculum in an academic institution will create sustainable human resource capacity.

<i>Number of National level PFM Steering committee meetings supported during the project period</i>	No.		16	4	6	9	16	20	24	Six monthly	AdminD ata	PEFA Secretar iat	
Carried out repeat PEFA assessment and prepared PFM reform strategy Phase II			Completed PEFA II		-	-	Completed PEFA II	Prepared PFM Phase II Strategy	Implementation Initiated	Six monthly	Admin Data	PEFA Secretar iat	
Number of seminars & workshops conducted for raising PFM awareness	No.		59 completed	10	20	35	50	70	90	Six monthly	AdminD ata	PEFA Secretar iat	

(\*) Baseline values for SPFM II would be the values as on June 2015.

## ANNEX 2: DETAILED PROJECT DESCRIPTION

### Background

1. The original project objective of SPFM is to improve expenditure control and enhance government accountability and transparency by strengthening the treasury system, improving financial reporting and building PFM capacity. The Strengthening Public Financial Management Reform (SPFM) project has been highly successful in implementing the Treasury Single Account (TSA) concept in a record time in Nepal with closure of over 13500 bank accounts. TSA has been rolled out across all 75 districts in Nepal at least a year before the target leading to 100% coverage of the budget. Real time budgetary expenditures are now available to all stakeholders through the website of the FCGO, which is having significant impact on the decision making behaviors of the line managers, and has helped improve the transparency in public finances.

2. These results are also clearly evident in the upgrade to several ratings in draft PEFA II report. Monthly budget executions reports (Ministry wise, Spending District wise, Economic Classification wise) have been strengthened and are available on a timely basis. Daily reports on aggregate budget implementation are also made available on the website and visual media (LED CTVs) located at strategic locations. Implementation for commitment recording across all 75 districts and pilots in respect of newly designed Revenue Management Information Systems (RMIS) in three large revenue receiving districts (Kathmandu, Lalitpur and Bhaktapur) have been initiated. Accounting Standards Board (ASB) successfully drafted the Nepalese Financial Reporting Standards (modeled on International Financial Reporting Standards) after an extensive consultative process. Pilots in respect of Nepalese Public Sector Accounting Standards have been successfully completed. After an extensive consultation amongst several stakeholders, Second Public Expenditure and Financial Accountability (PEFA) Assessment for Nepal has been finalized and is undergoing a final quality assurance and PEFA check.

3. SPFM II would: (i) continue to support the ongoing SPFM activities, while assisting GON in closing the financing gap in sustaining the TSA infrastructure; (ii) consolidate and sustain gains in TSA implementation, and (iii) enhance the Financial Management Information System (FMIS) for fully implementing commitment recording and enhancing revenue management.

4. SPFM II will not need a new design as it will continue with same Project Development Objectives and selected project components/activities which are required. However, this follow-on project will entail some adjustments in the Results framework, the Governance and Accountability Action Plan (GAAP), and Financial Management and Disbursement arrangements. SPFM II will continue to finance both recurrent and development expenditures, consistent with SPFM.

### Detailed Description of Project Components

5. The Project Development Objective (PDO) of SPFM II would remain same that is, “to improve expenditure control and enhance government accountability and transparency by strengthening the treasury system, improving financial reporting and building PFM capacity”. Overall breakdown of proposed SPFM II is given below:

(US\$)

<b>Component</b>	<b>Description</b>	<b>Project Cost US \$</b>	<b>MDTF share</b>
<b>1 (a)</b>	<i>Enhancing and Sustaining the Treasury Single Account (TSA) System (@75%)</i>	3,840,000	2,880,000

<b>1(b)</b>	<i>Replacement of treasury infrastructure at affected districts (@75%)</i>	240,000	180,000
<b>2</b>	<i>Strengthening accounting and reporting practices in public sector (@75%)</i>	160,000	120,000
<b>3</b>	<i>Supporting the capacity building of the PEFA Secretariat (@85%)</i>	588, 235	500,000
	<b>Total</b>	<b>4,838,235</b>	<b>3,680,000</b>

6. *Component 1(a) : Enhancing and Sustaining the Treasury Single Account (TSA) System (USD 2,880,000 million):* The original scope under component one involved: (i) implementation of the Treasury Single Account for efficient cash management; (ii) roll-out of FMIS (Financial Management Information System) for enhanced budget compliance during expenditure execution and payment process; (iii) further enhancement of the FMIS to support commitment accounting and improved financial reporting - aimed at strengthened expenditure controls and enhanced transparency. These were considered to be the foundational elements to provide a basic platform before beginning an ambitious journey of PFM reforms in Nepal.

7. For practical reasons, an iterative and incremental implementation approach was adopted to achieve the above objectives. Under this approach, the government agreed to implement reforms in small increments through iterative process, learning from the previous iteration and building onwards. Using this approach, first emphasis was on implementing expenditure Treasury Single Account, supported by FMIS roll-out in a phased manner across Nepal. In this regards, expenditure payments of ministries at Kathmandu and the 75 districts were centralized at the treasury offices, and processed through the FMIS, enabling the government close about 13500 bank accounts of these ministries, thus eliminating idle cash balances in these accounts. This comprised achieving 100% target during 2013, one year ahead of time. In addition, FMIS was rolled-out to all the districts treasury offices to ensure budget compliance during the expenditure payment processing at these offices. However, this iteration did not involve implementation of two major activities of the original scope: revenue TSA and commitment controls.

8. Currently, DTCO receives expenditure account statements from the respective bank and subsequently carries out expenditure account bank reconciliation almost on a daily basis. However, the situation with revenue reporting is not the same. The banks do not report revenue collections to the DTCOs in a timely manner, which leads to inaccurate information on government's aggregate cash position in the TSA. In addition, the foreign loans and grants receipts are not being captured in the FMIS, due to inadequately defined procedures and lack of system functionality. This has further contributed to inaccurate aggregate TSA cash position of the government in the FMIS.

9. Besides, the commitment control is not being practiced currently. The line ministries issue purchase-orders and contracts to the suppliers, without recording them in the system as commitments. Due to this, the government does not have information on its aggregate commitments that could allow appropriate cash planning to ensure commitments are paid in a timely manner to avoid any build-up of potential payment arrears.

10. To overcome the above limitation, the government plans to implement the next iteration of reforms in these two areas. This involves enhancing FMIS and rolling-out two additional modules across the 75 districts: commitment management and revenue management- RMIS (Revenue Management Information System). The development and roll-out of these modules will be preceded by revisions in relevant policies and procedures and training of the staff of the line ministries, FCGO and auditors of the SAI. The implementation of the commitment control module has been started as a proof-of-concept testing. Initial roll-out has begun with a significant attention on large spending district like Kathmandu and with a focus on large spending ministries like health and education sector. This will be followed up by further roll-out to

other large districts and remaining sectors. The target is to roll-out to all the districts DTCO offices and the line ministries. Budget rules, going forward, will also need to be appropriately refined to incorporate the end-of-the- year carry-forward commitments as defined in the revised business process.

11. The government plans to complete these reforms through SPFM II. Due to the massive change management challenges involved in successful accomplishment of these activities, the government anticipates a slower progress compared to the earlier rapid implementation of the expenditure TSA. Besides system roll-out mentioned above, the second area, and towards which major proceeds of the SPFM II will flow, relates to the upgrade of the IT infrastructure to enhance sustainability, security and efficiency of the systems. Key areas in this regards include Solar Power backup, Data Center and up gradation of network setup in FCGO and DTCOs and IT devices, including desktops and printers.

12. Again the IT infrastructure upgrade has been carried out through an iterative approach. When the project was initiated, the government had already developed and implemented the FMIS system in the initial few districts. It was envisaged that the project will finance, among others, the IT equipment for the central data center at the MOF and the district offices, including retroactive financing of equipment at the already implemented districts. However, due to the limited availability of funds under the project, the activities were prioritized. The key priority was given to the rapid roll-out of the TSA at the 75 districts. The IT infrastructure in the above mentioned three key areas were expected to be strengthened later. It was viewed that additional IT investments will be made after achieving the first iteration of the rollout, which required a huge behavioral change (withdrawal of cheque writing powers of line departments and its spending units) and was anticipated to take much larger time. The networking equipment acquired by government out of its own funds at that time was often of low capacity and has now become obsolete and it has not been upgraded during the last four years. This was done partly to save funds for the more prioritized activity of the TSA roll-out. Now that the system usage has increased over the last year, there is a need to upgrade this equipment for higher availability, better monitoring and performance management. Similarly, the worsening power outages necessitated acquisition of power back up equipment for only the large districts, leaving many other districts without appropriate power back-ups. The power outage in these districts has ranged from 8-16 hours. In addition, the data center, hosting high-end servers, needs to be upgraded for better monitoring of the data center environment suitable for these servers.

13. WB team has evaluated the IT infrastructure upgrades requested under proposed SPFM II. The requests have been based on the assessments of the three consultants. The consultants- networking consultant, power engineer and data center expert- were hired to make a realistic assessment of the equipment requirements and submitted their reports earlier this year. Based on these recommendations, the government in the next phase plans to enhance and upgrade its IT infrastructure and power-back-up arrangements more comprehensively and has requested to fund these activities through SPFM II. The sustainability of current IT infrastructure at FCGO is a major challenge with old/outdated, end-of-life/support for hardware and software. Aging or end-of-life equipment poses difficulties/disruptions in maintaining smooth operation and also leads to enhanced costs for maintenance. With the funding so far, results have been positive and the project needs to be taken to next level. Also, the SPFM II will ensure enough room for projected growth, more applications and data for next three to four years and will also include maintenance.

14. The major portion of the hardware upgrade is in the areas of network Infrastructure and power back-up. Both these are vital areas in terms of maintaining continuity of operation to run day-to-day business of FCGO and DTCOs. The availability and uptime of IT is important to maintain the efficiency of FCGO and DTCOs. Given the scenario of not having IT staff at all the districts, day-to-day support and maintenance remains a challenge. Delayed IT support leads to business delays. This situation will improve to quite an extent, using centrally managed technologies e.g. managed devices with centrally managed software

for network and security. The upgrades on the network side will also give better bandwidth which would improve application performance. This would lead to higher level of efficiency of FCGO and DTCO's staff.

15. Risk associated with continued IT support from the consultants is high as it is not sustainable. There is a need to build internal capacity and hire IT staff on permanent positions, to be created under the FCGO. In this regard, the Nepal Cabinet has recently approved such positions on the basis of a proposal mooted by MoF and hiring process has begun. The existing staff will be paired with IT consultant and newly hired staff to acquire on-the-job training. A detailed technical review of IT infrastructure proposed under component 1 is provided later in this annex.

16. Activities to be financed from the SPFM II: These included: (i) roll-out of commitment module; (ii) roll-out of revenue recording module; (iii) roll-out of cash management and electronic bank reconciliation; (iv) training and capacity building; (v) hardware and other IT and power infrastructure; (vi) consulting services to support the above activities; (vii) change management workshops.

17. ***Component 1 (b) : Replacement of treasury infrastructure at affected districts (USD 180,000):*** Given the recent earthquake in Nepal on April 25, 2015 and damages caused to treasury infrastructure in affected districts, GoN has requested Bank support to help quickly resurrect the payment function in these districts. As per reports made available, 30 districts have been affected of which 14 districts have been badly affected. Of these, three DTCOs (Sindhupalchok, Rasuwa and Nuwakot) treasury buildings have collapsed. There have been damages to computer equipment, power backup system, furniture and vehicles at all the affected districts. FCGO had issued the instructions, on the day after the earthquake, to all DTCOs to use manual system for issuing cheques wherever computer system/network was not available. It's remarkable to note that none of the DTCO had to use manual system. This was possible due to a web based TSA, fall back network access via Nepal Telecom and using bare minimum computer equipment in make shift locations, tents, rented premises and borrowed equipment from Nepal Army.

18. To allow these DTCOs to undertake regular operations, FCGO has made a request of funding to finance furniture, computer equipment, power backup system, house rents and repairs & maintenance. This would not include any civil works/construction. Civil works will be separately financed after a strategy emerges after damage assessment is completed by government of Nepal and a financing strategy is agreed. These damages were primarily self-assessed by each DTCO and verified on sample basis by HQ staff. An allocation of USD 180,000 is made to this activity which will be adjusted during implementation as further details emerge.

19. ***Component 2: Strengthening accounting and reporting practices in public sector (USD 120,000):*** As stated earlier, the NPSAS compliant financial statements for pilots conducted on two ministries have been completed and certified by ICGFM under the current project. This was led and coordinated by the accounting unit in the FCGO. Thereafter a high level stakeholder workshop was organized to review the results of the NPSAS pilots, specifically to review the costs and benefits of applying NPSAS, and to reach consensus on a recommended roadmap for improving public sector accounting and reporting in Nepal.

20. To demonstrate ownership, these two pilot departments have initiated the process of preparing NPSAS compliant financial statement for latest years and getting it audited by the Office of Auditor General. This will help complete the pilot and help establish credence in these financial statements. This will also help the stakeholders design a roadmap for the full-fledged implementation of NPSAS across line ministries under proposed SPFM II.

21. Under SPFM II, GoN is planning on scaling up the roll out of NPSAS across all ministries in a phase wise manner (5 in FY 16 and another 5 in FY 17). FCGO will lead this activity in coordination with line ministries and other key stakeholders. This activity will require consultancy support and adequate

training/capacity building activities will be undertaken while implementing at the level of line ministries. Trainings would need to be conducted to create awareness among stakeholders. A software utility will also need to be developed to analyze TSA data and prepare financial statements based on NPSAS. A practical rollout plan will need to be drawn up, which will take into account lessons learned from the previous pilot.

22. This component will fund the consultancy costs, the seminars/workshops, development of training modules and materials, associated costs of the accounting unit in FCGO and other related costs.

23. *Component 3: Supporting the capacity building of the PEFA Secretariat (USD 500,000):* The PEFA Secretariat has accomplished many significant achievements, as enunciated earlier. There is a need to continue activities on outreach, awareness, communication, training, research and capacity building to support PFM reform in Nepal. In addition, this component will also help support build national PFM training and capacity building capabilities by partnering with a local academic pioneer institution (such as Nepal Administrative Staff College) and working on developing a PFM core curriculum for public sector practitioners.

24. *Building In-country capacity for PFM Training Program:* FCGO completed a training needs assessment. Based on this assessment, discussions revolved around conducting accreditation courses on PFM. In addition to addressing the huge demand for PFM courses, this activity will also help address the skill gaps as are evident across GoN. The objective of this training program would be to collaborate with a national academic institution (like Nepal Administrative Staff College) and an international professional institute (such as CIPFA, CIMA, ACCA, INGAF etc.) in order to enhance knowledge on PFM among public officials. At present, an intense dialogue is taking place to identify a suitable international professional institute that will be able to offer structured PFM courses matching the needs of GoN and provide accreditation through a certificate/diploma. This activity will be a pilot. Lessons learned from this pilot will be assimilated to help design a PFM training project later on as part of PFM Reform Strategy Phase 2. An MoU shall be signed between the PEFA Secretariat, Nepal Administrative Staff College and the International Professional Institute by September, 2015, which will identify the national requirements to design the curriculum. For this purpose, the PEFA Secretariat will form a committee that will help focus the efforts. The international professional institute will provide trainers along with course materials while the national academic institute will provide classrooms, academic infrastructure and also incorporate elements of these classes to regular courses. This project will fund faculty and the initial fees for the selected long term courses. It is expected that the course offerings will begin by December 2015 with at least two round completed before the close of the project.

25. *PIUs and DPIUs strengthening program:* PFM reform related programs and activities are conducted by PFM Reform Implementation Units (PIUs) in line ministries and districts (DPIUs). The PEFA Secretariat has been conducting workshops, orientations and interaction programs on PFM at PIU level.<sup>9</sup> This will continue in SPFM II and the target is to cover 10 PIUs in the first year and 16 PIUs in the second year. Based on proposals received from DPIUs, the PEFA secretariat will provide resources to DPIUs to conduct PFM related activities such as radio programs, orientations and awareness on PFM. Under the SPFM II, the PEFA Secretariat aims to cover 25 DPIUs each year.

26. *PFM training:* The PEFA Secretariat has been delivering regional (five development regions) level trainings across the country. These trainings are focused on deepening knowledge among beginner level officers on accounting, budgeting, planning and internal control, TSA, MTEF, etc. This activity will be

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<sup>9</sup> Composition of PIU: Planning Chief (Coordinator), Planning Section (1), Finance Section (Member Secretary), Admin section (1) and Monitoring and Evaluation (1). Composition of DPIU: DTCO chief (Coordinator), DAO (officer), DDC planning officer, technical officer, private sector representative and representative from CSOs and DTCO nominated accounting staff.

further enhanced at the regional level through SPFM II. Through this component, the PEFA Secretariat aims to conduct five regional trainings each year (targeting 150 people). National level PFM trainings will be based on feedbacks from the previous trainings. Under SPFM II, one national level training will be conducted every year targeting around 40 people.

*27. Publication and dissemination:* The PEFA Secretariat has developed a communication strategy. Under SPFM II, the Secretariat will continue to publish six newsletters and two journals every year. These materials will be disseminated through the PEFA website, forums, training and distributed to ministries, libraries and various stakeholders. In addition, the PEFA secretariat will prepare and web publish quarterly progress reports in English under SPFM II.

28. *Research work and hiring of consultants:* The PEFA secretariat will hire consultants to conduct five research studies under SPFM II. These will include general and in-depth research studies. The research studies will be identified based on the findings from the second PEFA assessment. The PEFA secretariat will also hire national PFM consultant who will help the PEFA Secretariat in conducting PFM related activities (including development of training modules).

### **Detailed technical review of the IT infrastructure under component 1**

29. The focus of the review was to analyze the requirements in relation with the existing setup, investments done so far and to ensure that no major spending on IT equipments will be needed for the next 3-5 years. FCGO has been advised to procure all IT equipment with extended warranty period of 3 years.

30. The overall up-gradation of IT landscape of FCGO across Nepal and its requirement under SPFM II is based on the three consultants' reports - Data Center, Networking and Solar Power Backup. These reports were the basis of design and cost estimates in SPFM II. The consultants' reports are detailed current assessment along with suggested solution and Bill of Material (BOM) for up-gradation. These recommendations have been reviewed & reassessed by the Bank team from a strategic and cost benefit perspective while including them in the proposal for SPFM II.

31. Detailed activity wise costs are presented in Annex 3. The high cost of investment in IT is primarily in three areas, Solar Power backup, Data Center and up gradation of network setup in FCGO and DTCOs.

32. *IT Organization Structure:* IT infrastructure and its usage is fast becoming a lifeline for FCGO's functions and therefore needs to be accorded highest priority. In this backdrop most important one is building an IT Organization Structure of FCGO which is essential in sustaining and supporting this project and moving forward in overall reform of PFM strategy and use of technology in effective manner. The Bank has been informed that following IT positions have been approved by Cabinet for FCGO in a meeting held in January , 2015: (a) Senior Computer Engineer - IT Director,( equivalent to DFCG position) : 1 position, (b)Computer Engineers (1position for hardware+ 1 position for software), (c) Computer assistant/ Technical level- 2 positions. Given the market conditions and skills required, the team will also evaluate if it is more effective to hire a firm for position of IT consultants as identified. This will be indicated in the procurement plan. As said above the IT infrastructure has become the lifeline of FCGO and to maintain this, the capacity building of FCGO should be coupled with enhancement of IT setup to make it efficient, more reliable and more secure. This investment will last for next 3 to 5 years.

33. *IT and Office equipment:* This has new procurement and replacement of obsolete equipment. These include Desktops, Laptops, Printers, UPSs, Scanners, Photocopy and Fax machines. This replacement is based on old, obsolete, beyond repairs equipment, though there is no written down policy on replacement. FCGO has been advised to prepare a detailed IT Asset register which is under preparation. This will help

FCGO to plan their new procurement, replacement cycle and keep track of warranty maintenance (SLAs). Estimated costs are provided in Annex 3.

34. Data Center: The Data Center is the heart of FCGO's IT infrastructure which should be given priority in running it 24x7. The up gradation of Data Center include (a) Precision AC, Fire Detection System, Electric Panel, Racks etc. and (b) Network devices, Router, switches, Networking Monitoring System, Centralized Anti-Virus Software . This will lead to Tier 3 of Data Center. Estimated costs are provided in Annex 3.

35. Networking: Network cabling, switches etc. are the backbone of any IT Infrastructure. Up-gradation of Network is a high priority to match the load associated with TSA and RMIS upgrade. The current network system, switches, cabling are outdated, not efficient and not as per recommended International Standards.

36. Often, the limiting factor on performance is network congestion or overloaded switches and routers. The cabling is CAT5 in the entire network except for 2/-3 paying centers. The suggested CAT6 cabling which are more rigid; reduces noise and are more flexible. Cat6 specifications provide significantly lower interference or near end crosstalk (NEXT) in the transmission over CAT5. The result is less noise, fewer errors and higher data rates in the transmission of the signal.

37. The data collection from DTCOs indicate IT support required in network / connectivity which takes more time to resolve. With up gradation of basic network cabling and equipment along with centralized monitoring will reduce downtime and will enhance DTCOs productivity.

38. The up-gradation would also enable the entire network to control the functioning and move to redundancy through remote control without manual intervention. This online monitoring would enhance timely support from HQ and other regional centers.

39. There is no need to build a full 100% redundancy for routers at DTCOs and instead 10% spares can be procured in case of equipment failures. The estimated cost for active networking items (Routers, Switches) and for passive items (CAT6 and fiber cables, network panels, face plates, patch cords etc.) is provided in Annex 3.

40. Solar Power Backup: Uninterrupted power supply is very essential for any IT setup especially as it runs on central server architecture. The current situation of power in Nepal is not good. Statistics of load shedding has been provided by FCGO which justifies the investment. There are some districts where there is no power for 7-8 hours.

41. The solar power backup solution makes it ideal choice over other power backup technologies. The financial figure under this line item is based on solar power consultant's report. With no power it's like business stand-still for DTCOs. Having uninterrupted power supply for FCGO and DTCOs would reduce delayed processing, after office hours working and will enhance productivity.

42. RMIS Roll-out: The team was informed about the successful rollout of RMIS in three districts of Kathmandu valley. During the rollout, the software was tweaked with the inputs from concerned end users. The software is stable now.

43. With the plan to rollout RMIS in all districts in next two years, there is requirement of additional server for RMIS application. This will allow to create a separate cluster for fail-safe operation. The data base

server will remain same as that of TSA. The team has worked out the cost of RMIS Roll-out which is provided at Annex 3 and includes the server cost.

44. CGAS Pilot Phase Implementation: This was discussed in this mission and it has been confirmed that full implementation of CGAS is not under consideration. This will be initiated through a separate project due to large size, coordination issues (spending units being to line departments and not to FCGO's office) and large number of implementing entities involved (over 5000).

45. SPFM II will finance a pilot to demonstrate and test the usefulness of this approach. The estimated cost for the pilot phase implementation is \$ 30,000 where a software prototype will be developed and tested/piloted; will be offered to line departments and spending units for implementation. Experience garnered in this phase along with better understanding of impact, advantages and disadvantages of having CGAS at spending unit level will lead to a better informed design of possible intervention in this area.

46. Support Services and Consultancies: Support services will be required for ensuring TSA sustainability and to maintain high understanding, knowledge and operation of the TSA system by all users. In addition, SPFM II will also fund consultancies for development of medium term strategy for evolution towards full-fledged IFMIS/COTS solution, development of IT Strategy and conduct of IT/Functional Audit.

47. Operating Costs: These are for supplies like, toners, fuel, maintenance contracts and repairs.

## ANNEX 3: PROJECT COSTS

Strengthening Public Financial Management II				
Detailed Project Costs				
Component/Activitywise Cost Descriptions				
<b>Component I</b>				
S.N.	Descriptions of the Activities	Amount in US \$		
		MDTF Portion	GoN Portion	Total
1	Consultancy Services	86,250.00	28,750.00	115,000.00
2	Support, Installation/Implementation, Training and Orientation Services	256,282.50	85,427.50	341,710.00
3	IT staff/ Human Resources	303,500.25	101,166.75	404,667.00
4	Procurement of Regular IT Devices	132,487.50	44,162.50	176,650.00
5	Solar Power Backups for DTCOs,HW equipment (B-C-D Categories of DTCOs) incl contingency	296,694.00	98,898.00	395,592.00
6	Hardware & Associated software Data Center, FCGO and DTCOs incl contingency	1,446,941.25	482,313.75	1,929,255.00
7	Network Cabling	186,919.50	62,306.50	249,226.00
8	Softwares	47,175.00	15,725.00	62,900.00
9	Operating Costs	11,250.00	3,750.00	15,000.00
10	Replacement of treasury infrastructure at affected districts	180,000.00	60,000.00	240,000.00
11	Contigencies (where ever not provided)	112,500.00	37,500.00	150,000.00
<b>Total of Com 1</b>		<b>3,060,000.00</b>	<b>1,020,000.00</b>	<b>4,080,000.00</b>
<b>Component 2</b>				
1	Consultancy	75,750.00	25,250.00	101,000.00
2	Training and orientation	33,750.00	11,250.00	45,000.00
3	Operating Costs	10,500.00	3,500.00	14,000.00
<b>Total of Com 2</b>		<b>120,000.00</b>	<b>40,000.00</b>	<b>160,000.00</b>
<b>Component 3</b>				
1	Consultancies for PEFA Sect	17,000.00	3,000.00	20,000.00
2	Contractual Services	17,000.00	3,000.00	20,000.00
3	Various Trainings including National, regional, PIUs, DPIUs, PEFA orientation,media,journalist	127,500.00	22,500.00	150,000.00
4	In country Capacity building for PFM programs and courses	234,375.00	41,360.29	275,735.29
5	Communication and Printing	27,200.00	4,800.00	32,000.00
6	Research and Analysis	42,500.00	7,500.00	50,000.00
7	International Seminars, workshops and exposures	17,000.00	3,000.00	20,000.00
8	Operating Costs	17,425.00	3,075.00	20,500.00
<b>Total of Com 3</b>		<b>500,000.00</b>	<b>88,235.29</b>	<b>588,235.29</b>
<b>Grand Total</b>		<b>3,680,000.00</b>	<b>1,148,235.29</b>	<b>4,828,235.29</b>

(\*) - Further details in terms of activity wise and individual items are available in project file

ANNEX 4: GAAP

Areas of work	Issues likely to affect project performance	Actions to address the issues	Responsible agencies	Timelines	Early warning signs	Current Status
<b>1. Political and Administrative Environment</b>						
High-level political support to PFM	Frequent changes in government with shifting policy emphasis on PFM reform, including TSA, and financial reporting	As has been done under SPFM project, Ministers and other political leaders across the political spectrum will continue to be briefed regularly on the importance of PFM, including TSA and implications of any policy changes, and implementation of Nepal Public Financial Management Reform Strategy Phase I & Phase II (when drafted) Flexibility will be allowed in project implementation arrangements to accommodate suggestions for changes that do not affect project objectives.	PEFA Sect.	Regularly August and March every year, and immediately after a change in Government	Political decision-makers not fully aware of PFM and TSA reform efforts	<ul style="list-style-type: none"> <li>Continuous briefings to Finance Minister for last three years (and every time a minister joined). Briefings on specific issues have also taken place occasionally</li> <li>High-level workshop for senior policy makers organized in presence of Finance minister</li> </ul>
Commitment of administrative leadership to PFM reform	Constraint to internalization of PFM reform activities in line ministries	All GON Secretaries and other senior staff will be briefed on the findings of PEFA Repeat assessment (2015) and the Government's response (PFM Reform action plan) to them. Interactions with senior staff at line ministries will be held to brief them on Project activities and seek their feedback	PEFA Sect.  PEFA Sect	Continuous . First briefing on SPFM II prior to close of current FY i.e. in June 2015. Every six months after the effectiveness of SPFM II.	General perception that PEFA Sect. is part of FCGO.	<ul style="list-style-type: none"> <li>Several orientation sessions have taken place in sector ministries in last three years - attended by Secretaries.</li> <li>Having done the first round, plan to conduct one every four months beginning in Sept 2013)</li> <li>Regular Steering Committee and Working Committee meetings have conducted</li> </ul>
	No shared understanding on the role of PEFA Secretariat	TORs, composition, location of PEFA Secretariat will be reviewed/updated in line with evolving role, as and when required, and disseminated widely to all stakeholders at regular periods. The composition of National level PFM steering Committee will continue to be reviewed and updated to bring all stakeholders on board (i.e. the big spending ministries - Education, Health, MLD, MPPW)	PEFA SC  PEFA SC	Continuous  Continuous		<ul style="list-style-type: none"> <li>Completed for SPFM, to be reviewed with evolving role.</li> <li>TORs of PEFA Sect. have been disseminated. (document prepared)</li> </ul>
<b>2. Organizational Arrangements and Capacity Development</b>						

Areas of work	Issues likely to affect project performance	Actions to address the issues	Responsible agencies	Timelines	Early warning signs	Current Status
Coordination in project implementation	Weak coordination between central-level organizations with a role in PFM (e.g., OAG, FCGO, MoF, NPC)	The National level PFM Steering Committee will continue to meet at least every quarter to achieve better communication and coordination with representation from all members at the agreed level.	PEFA Secretariat	Every quarter	Frequent absence or lower level representation of members in SC meetings	<ul style="list-style-type: none"> <li>Twelve Steering Committee meetings have taken place (once in 4 months generally). (5 aug, Nov 29 2013, January 23 2014)</li> </ul>
	Fragmented responsibilities for implementing various project components	Heads of TSA, Accounting Unit (incl NPSAS), Nepal Staff Administration units and PEFA Secretariat will meet every month to review all project activities carried out during the month and agree any future course of action.	PEFA Secretariat	Monthly	Poor communication between the three component managers	<ul style="list-style-type: none"> <li>Regularly organized as planned</li> </ul>
Capacity building	PEFA Secretariat has inadequate capacity to handle project activities	An institutional strengthening approach paper will continued to updated and implemented to strengthen FCGO systems, PEFA Secretariat, TSA district units, and NPSAS pilots. Existing project supports to FCGO (e.g., IFMIS) will provide complementarities to the Project.	FCGO/ PEFA Sect	Updated by June 2015 and thereafter regularly	Delays in initial project activities	<ul style="list-style-type: none"> <li>A Capacity enhancement approach paper prepared and process is going on. Preferable to put in place a detailed plan</li> </ul>
	TSA units (DTCOs) in districts have inadequate capacity to sustain the results	TSA implemented DTCOs will continued be mobilized for refresher hands-on training in new district and staffing assessed	PEFA Sect	Continuous		<ul style="list-style-type: none"> <li>In the first phase, training programs have been conducted covering over 7,500 participants. Several TSA trainings have conducted.</li> </ul>
	Poor capacity of NPSAS pilot ministries in terms of internalizing international standards	Experience sharing events will be organized periodically to take stock of lessons learned and prepare action plan to mitigate the issues encountered. User manuals will be prepared for easy access to information	PEFA Sect/ FCGO/NP SAS Desk	June 2015 onwards	<ul style="list-style-type: none"> <li>Seminars organized for this purpose and needs to be continued as per plans</li> <li>NPSAS training and orientation events have been conducted and several more under SPFM II are planned</li> </ul>	
	Use of core staff is sub-optimal because of frequent staff transfer, especially in PEFA Secretariat and other units of	Core staff will remain in post for at least two years. No core staff will be transferred, if the remaining project period is less than one year.	FCGO/PEFA Sect	Regular	Weak compliance to FCGO decision on staff transfer issues	<ul style="list-style-type: none"> <li>Weak compliance due to institutional constraints.</li> <li>Efforts to retain staff in post will be strengthened in future also taking into account NPPR action plans</li> </ul>

Areas of work	Issues likely to affect project performance	Actions to address the issues	Responsible agencies	Timelines	Early warning signs	Current Status
	FCGO					
	IT interface/ organization in FCGO and other agencies is weak and unreliable	IT hardware and software systems will be upgraded in all Project entities (FCGO, MOF, TSA Units) as part of SPFM+SPFM II plans prepared. Staffing will be beefed up as per plans prepared	MOF/FCGO	Continuous	Poor performance and maintenance of IT systems	<ul style="list-style-type: none"> <li>First phase completed. Further upgrading is underway as a regular activity. Staffing plans for IT approved by cabinet.</li> </ul>
<b>3. Monitoring and evaluation</b>						
Inputs	There are delays in deployment and use of project staff. Disbursement of funds is delayed	<p>A staff deployment plan will be prepared to monitor staffing activities</p> <p>AWPB will be prepared and submitted to relevant authorities for timely disbursement of funds</p>	<p>PEFA Sect.</p> <p>PEFA Sect.</p>	<p>Continuous</p> <p>February each year</p>	Calendar of operations of the project becomes ineffective. Delay in flow of funds	<ul style="list-style-type: none"> <li>Ongoing</li> <li>Ongoing (Disbursement is timely)</li> </ul>
Processes	Lack of communications between project units affect performance	Communication Strategy prepared and implemented effectively	PEFA Sect	Continuous		<ul style="list-style-type: none"> <li>Communications strategy prepared. It is updated and shared.</li> </ul>
Outputs	Slipping deadlines for specific outputs. Weak quality assurance mechanisms	Early warning indicators will be put in place for important milestones. Project beneficiaries will be involved in monitoring project activities. Third party (independent) monitoring will be encouraged in project activities (like TSA impact evaluation)	PEFA Sect	Ongoing	<p>Public complaints about poor performance</p> <p>Unfavorable reports on project activities, including in the media</p>	<ul style="list-style-type: none"> <li>Ongoing</li> <li>Ongoing</li> <li>Third party evaluation of TSA impact under progress.</li> </ul>
<b>4. Transparency and accountability</b>						
Public access to information	Lack of transparency and access to information hinders citizens' participation in policy discussions on PFM, including TSA reform and public sector accounting reform.	All project information will be available on project website. Other media, including newspapers and electronic media, will also publicize information	PEFA Sect./FCGO	Regular	Grievances from stakeholders about poor transparency in project activities	<ul style="list-style-type: none"> <li>Ongoing</li> </ul>

Areas of work	Issues likely to affect project performance	Actions to address the issues	Responsible agencies	Timelines	Early warning signs	Current Status
	Lack of user-friendly IEC materials	Brief, accessible brochures will be produced regularly (and updated if required) for the public	PEFA Sect./FCGO	Regular		<ul style="list-style-type: none"> <li>Ongoing</li> </ul>
	Project authorities are not used to pro-active communication	RTI-consistency of project operations will be assessed every six months.	PEFA Sect./FCGO	August and March		<ul style="list-style-type: none"> <li>Ongoing</li> </ul>
Participation of stakeholders	There are not enough opportunities for stakeholders (e.g., line ministry offices) to participate	GoN line ministries and their district offices will be approached for feedback on Project performance. FCGO will have a grievance hearing unit to receive and act on suggestions/complaints from the public.	PEFA Sect./FCGO	At least annually. Web based grievance handling system to be put in place in Yr 1 of SPFM II	Complaints about poor project performance	<ul style="list-style-type: none"> <li>Ongoing</li> <li>There basic system is already in place, but this needs to be upgraded by making arrangements for web-based grievance handling systems (taking into account systems at other GoN agencies like. Dept of Roads)</li> </ul>
Achieving results	Project results and milestones are not clearly defined	Project outputs and outcomes will be defined clearly with measurable indicators to assess performance.	PEFA Sect. with support from Bank	Ongoing - for SPFM II by May 2015	Poor public engagement /interest in project activities	<ul style="list-style-type: none"> <li>Completed for SPFM</li> </ul>
	Inadequate dissemination of results	Project results will be publicized widely with lessons learned. Organize events for journalists.		Annual		<ul style="list-style-type: none"> <li>Training events have been organized for journalists.</li> <li>More events will be organized this year at the regional level to raise awareness about project activities.</li> </ul>

## ANNEX 5: SPFM IMPLEMENTATION PROGRESS

**1. Development Objectives and Outcome Indicators.** The project is on track to meet its development objective which is to: *“to improve expenditure control and enhance government accountability and transparency by strengthening the treasury system, improving financial reporting and building PFM capacity.”* **Annex 1** provides an update on the progress in the original project outcome indicators. End-of-project (EOP) targets have already been met or exceeded for three of the four PDO level indicators. The achievements of PDO level results as at June 30, 2015 is shown below:

Indicators	Unit of Measurement	Baseline	Year 3 Target	End-of-Project Target	Current status/ Comments
<b>PDO Level Results Indicators*</b>					
Percentage of overall budget executed through the DTCOs where the TSA system has been implemented	%	7	85	98	Nearly 100%. Target was achieved a year in advance
Budget Execution Reports and Financial Statements produced by the TSA system on a real time basis	No of districts	Nil	65	75	For all 75 districts. Quality and Timeliness has been improved further.
Preparation of consolidated financial statements for PILOT Ministries in accordance with Part 1, Cash IPSAS ;	No	Nil	1	2	Both the pilots have been completed (end of project target already achieved) and results being analyzed to upscale under SPFM II <sup>10</sup> .
Numbers of research studies into high priority PFM areas completed and disseminated	No	Nil	4	5	Two Reports completed, two drafted and another three proposed in this fiscal year which will be completed shortly.

**2. Overall Implementation progress.** In view of the good progress, both the “Achievement of PDO” and “Implementation Progress” are currently rated “satisfactory”. . Financial Management and Procurement performance has been rated Satisfactory.

### Detailed Summary of Implementation

**3.** The implementation progress under each component is summarized below.

**4. Component 1: Implementation of Treasury Single Account (TSA) System:** This component includes (a) implementation of a TSA system to enable real time budget checks prior to authorizing payment on expenditure transactions across all District Treasury Comptroller Offices (DTCOs) throughout the country and at the FCGO, and (b) further enhancement of the modified financial management information system (FMIS) to include commitment accounting, treasury/cash management, and financial reporting in accordance with International Public Sector Accounting Standards (IPSAS) cash part I. The overall progress of the component is “satisfactory”.

**5. Rollout of TSA:** Continuing as a hallmark move toward strengthening PFM systems, the complete rollout of TSA system across all 75 districts in Nepal has led to 100 percent coverage of the budget a year ahead of

<sup>10</sup> International Consortium for Government Financial Management (ICGFM) has certified these financial statements in December, 2014.

the planned schedule. Alongside improved management of idle cash balances, this complete rollout has helped centralize payments at District Treasury Controller Offices (DTCOs). The roll-out has also enabled the government to centralize the payment function at the DTCOs and strengthen TSA by closing down about 13,500 accounts. In terms of coverage, TSA is now able to cover almost 100% of budgeted revenue and expenditures<sup>11</sup> of the GoN. The system is able to support generation of consolidated cash flow statements for individual ministries as well as for the government. This component has helped achieve first of the two major objectives.

**6. Upgrading FMIS:** The second objective which was planned to be achieved through up gradation of FMIS to further strengthen the core treasury system is now proceeding satisfactorily. This includes, amongst others, recording of commitments, cash forecasting reports, secure automatic *daily* bank reconciliation, capturing of missing receipt information (e.g. customs, VAT, etc.) and development of additional reports. **Commitment Recording:** An international expert was hired through Bank executed trust fund who helped (in collaboration with FCGO officials) developed a blue print for implementing the commitment recording in the existing TSA system. Required software modifications in FMIS for implementing the recommended blue print were thereafter developed in-house by the software engineers of FCGO along with the development of the draft business process/reports and added to the existing TSA system as a separate module. Implementation of this new utility has now been started with a threshold of NPR 500,000 (i.e. this module will capture all commitments above NPR 500,000) as a proof of concept with plans to complete this under SPFM II.

**7. Revenue management/Cash Management/Daily Bank Reconciliation:** A task force developed business process for this module and software was configured accordingly by FCGO software engineers for testing. Pilots in three districts (Kathmandu, Bhaktapur and Lalitpur) have been started with effect from the beginning of FY 2015 which amount to about 45% of the total revenue of the government. An additional server will be required to be procured for this purpose, for which plans have been prepared. Additional server will also be put in cluster environment to give fail-proof server availability for all the applications. These pilots which faced significant issues in the beginning, is now moving ahead as FCGO officials have been successful in resolving many of these issues. FCGO team shared recent daily bank reconciliations for Kathmandu districts for three commercial banks which is a significant achievement considering that earlier these reconciliations use to take around 3-4 months on an average.

**8. Upgrading Technology Infrastructure:** In addition, the project scope also included upgrade of the technology infrastructure to support a stable and responsive TSA system. In this regard, the servers for the primary as well as the disaster recovery center have already been upgraded. Options for enhancing connectivity for the balance districts (primarily remote/hill districts) will be explored under SPFM II.

**9. IT Expertise:** A team of IT experts/project funded consultants has been hired<sup>12</sup> to provide technical support and maintain the system. Recently these IT experts have started developing software enhancements to existing FMIS (for commitment recording, and for enhancing cash/revenue management), necessitating a need for hiring more professionals. It was therefore agreed that FCGO will hire additionally two engineers. *This process is now quite advanced and the proposal for additional staff (1 IT Director, 1 hardware*

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<sup>11</sup>The expenditures include capital/donor funded projects. Payroll expenditures are recorded in the system on a summary voucher basis. The system records debt related transactions on an ex-ante basis, along with devolution of budget central government incurred through District Development Committees (DDC) (4 ministries – Agriculture, Livestock, Health and Education). The un-conditional grants to the local bodies and DDCs are recorded as expenditures at the time of transfer. These transactions contribute substantially towards comprehensiveness of budget execution coverage within the system for better reporting and improved controls.

<sup>12</sup>Numbers to be provided by FCGO.

*engineer and 1 software engineer) has been approved by Ministry of Finance and thereafter by the Cabinet of GoN. Hiring process has been initiated and is likely to be completed shortly.*

**10. Further rationalization of bank accounts:** Through centralization of payments through the TSA system, the government has also succeeded in consolidating its bank accounts by closing down about 13,500 of its bank accounts. There are however still some operative bank accounts of the government (1988 in total of which 445 are treasury managed accounts), which include accounts for current expenditure, capital expenditure, revenue, retention money, special purpose and miscellaneous accounts. Although with the TSA concept now fully implemented these accounts need to be incorporated into the TSA but there are several rules and requirements which mandate maintenance of these bank accounts. There is a need to reform this area and undertake a review on what can be done to rationalize these bank accounts further.

**11. Budget Execution Report (BER):** Substantial progress made in generating and disseminating Budget Execution Reports (BER). A daily budgetary status is now made available which depicts aggregate revenue, expenditures and budgetary surplus/deficit with a lag of just a day. In addition following monthly reports are now available: (a) Ministry wise Economic classification of the expenditures (b) Ministry wise budget, expenditures incurred and balance available and (c) District wise budget expenditures. **Reporting access to Line ministries:** The review team was informed that on-line access is now made available to the Ministry of Education after an additional reporting server was installed in May 2014. Plans are afoot to provide online access to other ministries. **Access to the Office of the Auditor General (OAG):** Following extensive deliberations at senior levels, online read-only, transaction level access of the TSA system is now made available to up to five concurrent users from the OAG. This is expected to substantially facilitate the use of Computer Aided Audit Techniques (CAAT) by OAG and undertake/plan audits on the basis of assessed risks. Impact in this regard is likely to be felt in the audit of the financial statements for 2014/15.

*Component 2: Strengthening accounting and reporting practices in public and private sector*

**12. Component 2(a): Private sector accounting and reporting:** The Accounting Standards Board (ASB) has formulated 40 NFRSs and the Institute of Chartered Accountants of Nepal (ICAN) has pronounced them in September 2013. ASB has planned some activities such as preparation and development of NFRS for SMEs, guidance notes for 15 NFRSs, training for trainers on NFRSs and exposure visit.

**13.** The MoU between PEFA Secretariat and ASB which was till July 16, 2014 was extended to December 31, 2014 at no extra costs. A current status of work completed up to the first trimester has been shared according to which almost all work has been completed. ASB has completed most of the actions such as 15 guidance notes drafted, conducted trainer the trainer (TTT) program for qualified Chartered Accountants and publication of NFRSs.

**14.** Going forward, mandate for implementation of NFRS in Nepal is the prerogative of ICAN as per institutional framework (ASB's primary mandate is to promulgate standards) for which a separate follow up/capacity building dialogue will take place under the aegis of "Report on Observance of Standards and Codes - Accounting and Auditing (ROSC- A&A) which has recently been completed. This necessitates a slight revision in an intermediate result indicator with reference to the State Owned Enterprises (SOEs).

**15. Component 2(b): Public sector accounting and reporting:** The NPSAS compliant financial statements for FY2011/12 and FY2012/13 pilot on two ministries (MoPIT and MoWCS) have been completed. These financial reports have been certified by ICGFM in a valedictory function held recently in Washington DC, USA. For this the FCGO (with support from consultants) also organized a high level stakeholder (OAG, MoF, NPC, FCGO, Line departments and others) workshop in July 2014 to review the results of the NPSAS pilots, specifically to review the costs and benefits of applying NPSAS, and to reach

consensus on a recommended roadmap for improving public sector accounting and reporting in Nepal. It was agreed that the two pilot departments after having been trained will start taking steps towards preparing NPSAS compliant financial statement of FY2013/14 in these two line ministries and have it audited and certified by the Office of Auditor General. It was agreed that F/S for 2013-14 will be completed shortly and be audited thereafter. This will complete the pilot and help establish credence in these financial statements. This will also help the stakeholders design a roadmap for the full-fledged implementation of NPSAS across line ministries under SPFM II.

*Component 3: Supporting the capacity building of the PEFA Secretariat:*

**16.** The PEFA Secretariat continues its exemplary efforts in reaching out to various stakeholders across the country to more remote districts, demand side stakeholders, line departments and general public in increasing PFM awareness and building a solid foundation for ensuing PFM reform processes. The Secretariat has published nine newsletters and three journals till date, which have been distributed to districts, PIUs, DPIUs, ministries and training institutes and also published on the website of the PEFA Secretariat for wider dissemination. There has also been good press coverage on PEFA Secretariat lead events. A radio program dedicated to disseminating information on PFM reform through interviews with various public sector experts on PFM has also been initiated under the project. Research work has been completed in two areas. Out of five high priority areas decided for current year<sup>13</sup>, two reports have been drafted and another three are likely to be completed shortly.

**17.** With regard to autonomy and sustainability of the PEFA Secretariat, the team has been advised that a separate budget authorization has been provided by GoN. *Second PEFA Assessment:* Under the leadership of GoN, the second PEFA assessment has been finalized and published. The decision review meeting took place in December, 2014 which brought together government officials from MOF, FCGO and PEFA Secretariat, Nepal and MDTF DPs along with the PEFA team from the World Bank. Government of Nepal's commitment and ownership to drive the process and to own the results of the assessment has been impressive and is helping preparation of the PFM Reform Strategy Phase II. It has been agreed that the second phase PFM action plan will be finalized with a consultation of broader stakeholders which will help crystallize PFM MDTF future work program and the GoN's PFM program<sup>14</sup>.

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<sup>13</sup> High priority studies are (a) Study on Internal Audit System in Nepal; (b) Feasibility study on establishing a National Institute of PFM; (c) Impact of government investment in public enterprises in terms of loan and share investment; (d) Impact of implementation of TSA in public finance; and (e) Pattern and implication of off-budget items in public financial accountability.

<sup>14</sup> Preliminary discussions in respect of action plan have already been started by PEFA secretariat in Nepal. This is likely to emerge shortly

## ANNEX 6: FINANCIAL MANAGEMENT ARRANGEMENTS

1. **Implementing Entity:** As in the original project, the PEFA Secretariat will be the main implementing agency. The cost centres will implement the activities and report to the PEFA Secretariat. The current financial management rating of SPFM I is “Satisfactory”. The ongoing review of the financial records reveals that the procedures in place are considered adequate to ensure that the fiduciary risk is minimized.
2. **Budgeting:** PEFA Secretariat will prepare an annual work program and budget for project related expenditures. Annual work program and budget will be submitted to NPC and MoF for approval and budget allocation. MoF will allocate annual budget to PEFA Secretariat under a separate budget code. MoF will issue budget authorization to PEFA Secretariat. PEFA Secretariat will provide budget authorization to cost centers for activities to be implemented by respective cost centers.
3. **Funds Flow:** Based on the authorization received from MoF, PEFA Secretariat will provide budget release authority to cost centres to implement components 1A, 1B and 2. PEFA Secretariat will implement component 3.
4. **Staffing:** PEFA Secretariat will have a dedicated and full time accounts officer to undertake overall financial management responsibility which includes coordination and supervision for: (i) annual budget/program preparation; (ii) funds flow management; (iii) accounting and reporting; (iv) internal controls and auditing. He/she should be assisted by accountant and support staff. The training and capacity building on FM will be provided during the implementation of the project.
5. **Accounting:** The project will maintain accounts of their expenditures following the government accounting system and respective Financial Procedure Act and Regulations. PEFA Secretariat and cost centres will be responsible to maintain books of accounts as per Govt. cash basis accounting system. The project will also need to maintain record of contractors, designated bank accounts, grant/credit register, and statements of expenditures.
6. **Financial Reporting:** An Interim Unaudited Financial Reports (IUFs) will be prepared based on financial statements obtained from the cost centres and its own. PEFA Secretariat will submit separate IUFs to IDA every trimester (four months) within 45 days from the trimester-end. This IUF will clearly segregate the expenditures made under SPFM I and SPFM II. A consolidated unaudited project account including the original project will be submitted within three months from the end of each fiscal year.
7. **Internal controls and internal audit:** PEFA Secretariat will devise internal control system suitable to the activities to be implemented by them. The DTCOs will conduct internal audits on trimester basis of the implementing agencies.
8. **External Audit:** The Office of the Auditor General (OAG) will conduct external audit of the project. PEFA Secretariat will submit consolidated audited project financial statement including the original project to IDA within six months from the end of each fiscal year. All records (including contracts, orders, invoices, bills, receipts and other relevant documents evidencing all expenditures) will be kept properly and the Bank's representatives will have the access to them for the purpose of examination)
9. **Supervision Plan:** IDA will follow a risk based approach in supervising the FM activities of the project including field visits.

10. Disbursement Arrangements: The GoN will pre-finance the project expenditures and direct payment through IDA will also be available. The Coordinator and Member Secretary of the PEFA Secretariat will be authorized signatories for IDA disbursements and will handle the Designated Account. As in the original project, disbursements will be report based. The Designated Bank Account of the original project will be used for this project.

11. Disbursement categories: The disbursement categories are as follows:

<b>Category</b>	<b>Category Description</b>	<b>Amount of Financing Allocated (USD)</b>	<b>Percentage of Expenditures to be Financed (inclusive of taxes)</b>
<b>1 (a)</b>	<i>Good, consulting services and operating costs related to component 1(a)</i>	2,880,000	75%
<b>1(b)</b>	<i>Good, consulting services and operating costs related to component 1(b)</i>	180,000	75%
<b>2</b>	<i>Good, consulting services and operating costs related to component 2</i>	120,000	75%
<b>3</b>	<i>Good, consulting services and operating costs related to component 3</i>	500,000	85%
<b>Total</b>		3,680,000	

12. Disclosure of information: Project would be required to disclose the following: (i) Audited Project Financial Statements; and (ii) Details of major contracts.

13. Retroactive Financing: As this project is a follow on of the original project, there is no need for retroactive financing.

## ANNEX 7: PROCUREMENT ARRANGEMENTS

### A. General

1. Procurement for the Project will be carried out in accordance with the World Bank's "Guidelines: Procurement of Goods, Works and Non-consulting Services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" published by the World Bank in January 2011, revised July 2014 ("Procurement Guidelines"), in the case of goods, works and non-consulting services; and "Guidelines: Selection and Employment of Consultants under IBRD Loans and IDA Credits and Grants by World Bank Borrowers" published by the World Bank in January 2011, revised July 2014 ("Consultant Guidelines") in the case of consultants' services, and the provisions stipulated in the Legal Agreement. For each contract to be financed under the Credit, procurement methods or consultant selection methods, the estimated costs, prior review requirements, and time frame will be agreed between the Borrower and the Bank in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity. The general description of various items under different expenditure category is described below.

### B. Selection of Consultants:

2. Consultancy services required for the project will be acquired through selection of individual consultants and consulting firms. Single-Source Selection of consulting firms and individuals may be used only if it presents a clear advantage over competition for the required consulting services in accordance to paragraph 3.8. Selection of Consulting Firms through Consultants' Qualification (CQS) may be appropriate for assignments estimated to cost not exceeding US\$300,000 equivalent in accordance with paragraph 3.7 of the Consulting Guidelines. In certain cases, other methods of consultant's selection under the Consultant Guidelines may be adopted depending on the nature of the activities. If enough firms have not submitted the expressions of interest, shortlist may have lesser than 6 firms.

### C. Procurement of Goods, Works and Non-Consulting Services:

3. Procurement of works has not been envisaged under the project at this point. However, in case of need, Bank's Procurement Guidelines and methods described below will apply.

4. Direct Contracting: Direct contracting for the procurement of goods (paragraph 3.7 of the procurement Guidelines) may be used to extend an existing contract or award a new contract. For such contracting to be justified, the Bank should be satisfied that the price is reasonable and that no advantage could be obtained by further competition.

5. Shopping: Shopping method in accordance with paragraph 3.5 of the Procurement Guidelines will be adopted for procuring readily available off-the-shelf goods of value less than US\$50,000. For shopping procedure, list of vendors/contractors already registered with government departments may be used for inviting quotations. The procurement plan should determine the cost estimate of each contract, and the aggregate total amount. The Borrower should solicit at least three price quotations for the purchase of goods, or services (non-consulting), to formulate a cost comparison report.

6. National Competitive Bidding (NCB): Any contract estimated to exceed shopping threshold will be subject to NCB. In order to ensure economy, efficiency, transparency and broad consistency with the provisions of Section 1 of the Procurement Guidelines, the following exceptions shall apply in the case of NCB:

- a) Only the model bidding documents for National Competitive Bidding agreed with the Association (as amended from time to time), including qualification criteria shall be used;
- b) Bid documents shall be made available, by mail or in person, to all who are willing to pay the required fee;
- c) Foreign bidders shall not be precluded from bidding and no preference of any kind shall be given

to national bidders;

d) Bids shall be opened in public in one place, immediately after the deadline for submission of bids;

e) Qualification criteria (in case pre-qualifications were not carried out) shall be stated in the bidding documents, and if a registration process is required, a foreign firm declared as the lowest evaluated bidder shall be given a reasonable opportunity of registering, without let or hindrance;

f) Evaluation of bids shall be made in strict adherence to the criteria disclosed in the bidding documents, in a format and specified period agreed with the Association and contracts shall be awarded to the lowest evaluated bidders;

g) Rebidding shall not be carried out without the prior concurrence of the Association;

h) Extension of bid validity shall not be allowed without the prior concurrence of the Association (A) for the first request for extension if it is longer than four (4) weeks and (B) for all subsequent requests for extension irrespective of the period; and

i) There shall not be any restrictions on the means of delivery of the bids.

j) Provisions related to performance security, bidding requirement, qualification requirement, rebidding, and contract management shall be agreed with the Association in the model bidding document.

7. International Competitive Bidding (ICB): No ICB contracts have been foreseen at this point, however, if it comes up the Borrower shall use Bank's SBDs.

#### **D. Implementation Arrangements And Capacity Assessment Of The Implementing Agencies**

8. The implementation arrangement of the SPFM-II Project will remain the same as in the ongoing SPFM project. Components 1 and 2 will be implemented by FCGO at center and by 75 DTCOs at district level under the supervision of FCGO. Component 3 will be implemented by the PEFA Secretariat. For effective procurement management, FCGO will have a procurement officer of level Gazetted 2nd class and PEFA Secretariat will also have a procurement officer of level Gazetted 3rd class. The project will use e-GP system developed by Public procurement Monitoring Office (PPMO) as appropriate.

9. The capacity assessment of the implementing agencies was carried out based on the observation of procurement performance of implementing agencies under the ongoing Bank financed SPFM project and post review findings and interview with relevant officials. The assessment looked at the resources and internal procedures as well as its understanding and familiarity with the Bank's guidelines, procedures, documentation etc. Since regular civil servants are deputed as procurement officers, there is a chance of delay in initiating procurement process due to their responsibility of involvement in various jobs in addition to procurement. In general, the overall system looks fairly good and joint fiduciary risk for this project has been rated as Moderate.

10. In order to mitigate the above risks, though not substantial, the following mitigation measures has been proposed: (i) procurement officers deputed in FCGO and PEFA Secretariat should be dedicated for the procurement job only to the extent possible; (ii) recruitment of procurement support consultants with intermittent input as per need; and (iii) training of staff involved in procurement initiation, reviewing and decision making.

#### **E. Procurement Plan**

11. A procurement plan for existing project with one year extension and for SPFM II has been prepared and will be finalized before project negotiations. The Procurement Plan once finalized will be made available in the Project's database and in the Bank's external website. The Procurement Plan will be updated annually or as required to reflect the actual project implementation needs and improvements in institutional capacity. The Project will also use the proposed procurement plan monitoring tool - SEPA or STEP as the project implementation advances.

#### **F. Frequency Of Procurement Supervision And Review By The Bank**

12. The Bank will normally carry out the implementation support mission on semi-annual basis. The frequency of the mission may be increased or decreased based on the procurement performance of the Project.

13. **Prior Review:** The Bank will prior review following contracts: (a) Goods: All contracts of value above US\$ 3 million equivalent; (b) Consultancy Services: All contracts of value above USD 1 million equivalent for firms; and above USD 0.3 million equivalent for individuals. All procurement consultants will be prior reviewed regardless of their value.

14. **Procurement Methods:** For Goods, and Non-Consulting Services: ICB, LIB, NCB, Shopping, and DC. For Consulting Services: QCBS, QBS, FBS, LCS, CQS, SSS for firms and Individuals, and Individual Consultants.