

Report and Recommendation of the President to the Board of Directors

INTERNAL

Project Number: 59193-001
November 2025

Proposed Policy-Based Loan for Subprogram 2 Nepal: Strengthening Public Financial Management and Devolved Service Delivery Program

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Asian Development Bank

CURRENCY EQUIVALENTS (as of 16 October 2025)

Currency Unit	–	Nepalese rupee/s (NRe/NRs)
NRe1.00	=	\$0.00709
\$1.00	=	NRs140.90

ABBREVIATIONS

ABP	–	annual borrowing plan
ADB	–	Asian Development Bank
ADFF	–	Alternative Development Finance Fund
ADFM	–	Alternative Development Finance Mobilization
FY	–	fiscal year
GDP	–	gross domestic product
IMF	–	International Monetary Fund
IPFMS	–	integrated public financial management system
MOF	–	Ministry of Finance
MTEF	–	medium-term expenditure framework
PAMS	–	public asset management system
PDMO	–	Public Debt Management Office
PEFA	–	public expenditure and financial accountability
PEMIS	–	public enterprises management information system
PFM	–	public financial management
PPP	–	public–private partnership
PPPF	–	post-program partnership framework
SNG	–	subnational government
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government of Nepal and its agencies ends on 15 July. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2025 ends on 16 July 2025.
- (ii) In this report, “\$” refers to United States dollars.

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¹ The International Monetary Fund confirmed on 7 October 2025 that the attached Staff Report may serve as the International Monetary Fund assessment letter.

PROGRAM AT A GLANCE

1. Project Data					
Project number	59193-001	Project name	Strengthening Public Financial Management and Devolved Service Delivery Program (subprogram 2)		
Country	Nepal	Executing or implementing agency	Ministry of Finance/ Asian Development Bank		
Sector office	Public Sector Management and Governance Sector Office	Geographical location	Country		
Sector(s)	Public sector management	Subsector(s)	Decentralization; Economics Affairs Management; Law and Judiciary; Public Administration; Public Expenditure and Fiscal Management; Reforms of State-Owned Enterprises; and Social Protection Initiatives		
Country economic indicators	https://lnadbq4.adb.org/sec0066p.nsf/vwLkupAttachments/LNAD-DN6BUN/\$file/Country%20Economic%20Indicators_updated%2028%20Oct%202025.pdf	Portfolio at a glance	https://lnadbq4.adb.org/sec0066p.nsf/vwLkupAttachments/LNAD-DKKA9E/\$file/Portfolio%20at%20a%20Glance.pdf		
Strategic Focus Area	Resilience and empowerment; Climate action; Private sector development; and Digital transformation	Sustainable Development Goals	SDG 11.a		
Lending modality	Programmatic Approach Policy-Based Lending (Loan)				
2. Financing					
ADB Financing		Amount (\$ million)			
Regular ordinary capital resources loan		0.00			
Concessional ordinary capital resources loan		100.00			
Special Funds resources (ADF grant)		0.00			
Cofinancing		Amount (\$ million)			
ADB-administered		0.00			
Not ADB-administered		0.00			
Counterpart		Amount (\$ million)			
Government		0.00			
Total		100.00			
{ADB Climate Financing}					
ADB					
Adaptation		13.00			
Mitigation		4.50			
Cofinancing (ADB-administered)					
Adaptation		0.00			
Mitigation		0.00			
Total		17.50			
Currency of ADB Financing: US Dollar					
3. Climate Action					
Absolute GHG emissions (tCO₂e per year)			0		
Relative GHG emissions (tCO₂e per year)			0		
Climate change risk on the project without adaptation measures			Low		

Disaster Risk Management, Environment and Nature	Not Applicable
4. Private Sector Development	
Private capital mobilized (\$)	
PSD classification	No-PSD
5. Safeguards	
Category	Environment: <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI Involuntary resettlement: <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI Indigenous Peoples: <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI
6. Gender Equality	
Category	<input type="checkbox"/> Gender equality objective (GEN) <input checked="" type="checkbox"/> Effective gender mainstreaming (EGM) <input type="checkbox"/> Some gender elements (SGE) <input type="checkbox"/> Indirect gender benefits (IGB)
7. Poverty Reduction and Inclusion	
Category	<input type="checkbox"/> Poverty reduction and inclusion focus (PIF) <input checked="" type="checkbox"/> Poverty reduction and inclusion elements (PIE) <input type="checkbox"/> Indirect poverty reduction and inclusion (IPI)
8. Regional Cooperation and Public Goods	
Category	<input type="checkbox"/> Pillar 1 <input type="checkbox"/> Pillar 2 <input type="checkbox"/> Pillar 3 <input checked="" type="checkbox"/> Not applicable
9. Digital Transformation	
Category	<input type="checkbox"/> Level 1 <input checked="" type="checkbox"/> Level 2 <input type="checkbox"/> Level 3 <input type="checkbox"/> Level 4 <input type="checkbox"/> Not applicable

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I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan to Nepal for subprogram 2 of the Strengthening Public Financial Management and Devolved Service Delivery Program.
2. Subprogram 2 builds on the reforms under subprogram 1 and supports Nepal's national and subnational public financial management (PFM) reforms. The overarching objective is strengthening fiscal sustainability and fiscal federalism in line with the Government of Nepal's 16th five-year plan.² The program targets two main reform areas: (i) public expenditure and debt management at the national level to rationalize public spending and improve capital budget absorption and (ii) resource planning and management at the subnational level to improve the delivery of public services that were devolved to subnational governments under the 2015 constitution.
3. Following the youth-led ("Gen Z") protests leading to the fall of the coalition government and formation of an interim government on 12 September 2025, subprogram 2 is proposed as advised by the interim government to continue development support as planned and agreed (under the previous governments). Strengthening fiscal sustainability and economic recovery following the protests would require an integrated approach with a mix of economic and fiscal policies and institutional reforms. Subprogram 2 is timely and relevant in this regard as the reform measures implemented under the program contribute to increasing fiscal space through expenditure rationalization, increased resource mobilization, reduced fiscal risks, innovative financing, and good governance. These are achieved through the implementation and institutionalization of policy reform actions, such as fiscal risk strategies, annual borrowing plans, management and governance policy of public enterprises, PFM reform strategy, medium-term expenditure framework, and mobilization of alternative development financing fund. Further, institutional reform actions, such as operationalization of public enterprises management information system, integrated PFM system, digitized revenue administration system and public asset management system are instrumental in enhancing operational efficiency, reducing costs, and improving transparency, accountability, and coordination.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

4. **Macroeconomic context.** Nepal is a landlocked country in South Asia with a population of about 30 million and gross domestic product (GDP) of \$42.9 billion in FY2024. It is a lower middle-income country with gross national per capita income of \$1,470 (Atlas method) in 2025. The United Nations classifies Nepal as a least-developed country. By maintaining macroeconomic stability and moderate economic growth (averaging 4.3% from FY1996 to FY2024), Nepal has shown economic resilience, while reducing extreme poverty³ from 55% in 1955 to 0.37% in 2023. These achievements are noteworthy despite political volatility, structural challenges, and multiple disasters triggered by natural hazards.⁴ Nepal's annual economic growth is estimated to accelerate from 3.9% in FY2024 to 4.6% in FY2025. Growth in FY2026, however, is projected to fall to 3.0% following the civil unrest in September 2025, which will likely decelerate industrial

² Government of Nepal, National Planning Commission. 2024. [*The Sixteenth Plan \(Fiscal Year 2024/25–2028/29\)*](#).

³ Defined by the \$2.15 per day threshold.

⁴ Asian Development Bank (ADB). 2025. *Country Partnership Strategy: Nepal, 2025–2029—Inclusive and Sustainable Growth Assessment*.

growth as mining, quarrying and construction remain subdued in a broader economic slowdown, with manufacturing weighed down by political volatility, security concerns, and eroded investor confidence.⁵ In addition, tourism-dependent activities are expected to be hit hard. To maintain or accelerate economic growth, Nepal needs to continue policy and institutional reforms, including (i) strengthening public investments to improve budget execution, (ii) promoting digitalization of PFM systems to improve transparency and efficiency, and (iii) improving tax administration and local revenue generation.

5. Fiscal context. In FY2025, the fiscal deficit narrowed to 2.0% of GDP from 5.8% in FY2023 despite the decline in tax revenue-to-GDP ratio from 19.1% in FY2019 to 16.8% in FY2024, which highlights the government's inability to fully utilize the budget rather than more efficient allocation. Capital expenditure decreased from 4.7% of GDP in FY2016 to 3.4% in FY2024. The September unrest has disrupted economic activities leading to reduced tax collection, which will widen fiscal deficit in FY2026. Meanwhile, the public debt-to-GDP ratio has soared since the coronavirus disease pandemic—from 27.2% in FY2019 to 42.7% in FY2024.⁶ Although it is within the target of 50% set by the medium-term debt management strategy, debt servicing costs have risen substantially.⁷ Yet, the International Monetary Fund (IMF) assessed Nepal as being at low risk of debt distress—for both external debt (51.5% of the total debt) and overall public debt—because of high and sustained remittance inflows, which serve as buffer for foreign exchange and debt repayment capacity. Further, most of Nepal's external debt is concessional (low interest rates and long maturities).⁸ Based on these factors, Asian Development Bank (ADB) assesses the quality of Nepal's macroeconomic framework and policies as *satisfactory*.

6. Development aspiration. Nepal aims to graduate from least-developed country status to developing nation status by 2026, in line with achieving the Sustainable Development Goals. The government's 16th Plan outlines its development aspirations, emphasizing good governance, social justice, and prosperity. It targets average annual economic growth of 7.1% from FY2025 to FY2029 and per capita income of \$2,351 by FY2029. The plan also proposes increasing public capital expenditure's share (of total expenditure) from 16% in FY2023 to 29% by FY2029 and reducing the portion of recurrent spending from 71% in FY2023 to 55% by FY2029.⁹

7. Binding constraints. Weak public expenditure and debt management at the national level and poor resource planning and management at the subnational level have been some of the major constraints to fiscal sustainability and fiscal federalism in Nepal. These constraints are discussed in paras. 8 and 9 below.

8. Weak public expenditure and debt management (at the national level). Chronically low capital allocations and spending are constraining Nepal's economic growth. The federal government's capital budget absorption rate averaged 65.7% from FY2017 to FY2025, compared to 86.5% for the recurrent budget. Capital expenditure as a share of total expenditure fell from 24.9% in FY2018 to 14.6% in FY2025; and 4.7% in FY2016 to 3.6% in FY2025 as a share of GDP. Nearly 25% of capital spending occurred in the last month of the fiscal year, raising doubts

⁵ ADB. 2025. [ADO Update September-2025](#)

⁶ ADB. 2024. [Nepal Macroeconomic Update](#).

⁷ The government's costs on interest jumped from 0.5% of GDP in FY2019 to 1.4% of GDP in FY2023, accounting for 7.6% of federal revenue. In FY2024, the debt service cost surpassed capital spending with total debt service (combined interest and principal) reaching over 5% of GDP [Source: IMF. 2024. Fourth Review Under the Extended Credit Facility Arrangement – Debt Sustainability Analysis]

⁸ IMF. 2023. [Debt Sustainability Analysis](#).

⁹ Government of Nepal, National Planning Commission. 2024. [The Sixteenth Plan](#).

about the quality and longevity of the assets created (as procuring agencies cut corners to meet deadlines and not pay due attention to value for money or sustainability). While capital expenditure has remained low, recurrent expenditure increased from 14.2% of GDP in FY2016 to 16.1% in FY2025. Revenue collections have also weakened, leading to faster accumulation of public debt. Low capital spending and weak debt management can be attributed to the following factors:

- (i) **Increased fiscal risks.** Fiscal risks arise from sources such as changes in macroeconomic conditions, natural hazards, and government guarantees. As the government lacks methodical assessments of fiscal risks and effective strategies to address those risks, budgets are unrealistic. Potential future costs and liabilities are not carefully considered during budget formulation.
- (ii) **Inefficient debt planning and management.** In the absence of appropriate planning tools and guidelines, Nepal's debt operations are not streamlined or coordinated. This has hindered cost-effective borrowing and contributed to fiscal risks. Because the government lacks policy guidelines for assessing contingent liabilities of public enterprises, those liabilities are not accurately reflected in the debt calculation. The 2024 public expenditure and financial accountability (PEFA) highlighted gaps in the identification, monitoring, and reporting of contingent liabilities and fiscal risks associated with public enterprises.¹⁰
- (iii) **Poor management and governance of public enterprises.** In the absence of appropriate policies, guidelines, and systems, the performance of public enterprises has deteriorated, increasing fiscal risks.¹¹ Audited annual financial reports of public enterprises are often published with long delays, and the management information system for public enterprises is obsolete. This has resulted in huge information gaps and inefficient management practices.¹² Without clear policies, government investments have been ad hoc, increasing its credit risk exposure.¹³ Further, contingent liabilities of public enterprises pose fiscal risks in the absence of a standardized framework to assess such liabilities.
- (iv) **Fragmented public financial management systems.** Nepal's fragmented PFM systems lack automation, which undermines operational efficiency. Planning and coordination are also weak. These gaps have contributed to inefficient expenditure management, incomplete financial reporting, and delayed project implementation—all of which increase project costs. Although the government prepared PFM reform strategies in the past, they were not coherent across all government tiers or fully aligned with the constitutional provisions for fiscal federalism.

9. Inadequate resources and poor resource planning and management (at the subnational level). Nepal's constitution provides for three government tiers: federal, provincial, and local. It aims to devolve power to subnational governments (SNGs) to improve the quality of public goods and services, increasing inclusive and sustainable economic growth. However, the transition to the federal system of governance has not been smooth, particularly the implementation of the fiscal federalism framework. Expenditure and revenue functions, as well as the authorities of all government tiers, remain unclear, overlapping, and not fully aligned with the federal structure as per the 2015 Constitution (footnote 3). Nepal's intergovernmental system has created a large vertical fiscal gap: more than 85% of revenue goes to the federal government,

¹⁰ The World Bank. 2024. [Nepal Public Expenditure and Financial Accountability \(PEFA\) assessment](#).

¹¹ In FY2024, about one-third of the 45 public enterprises incurred losses and two reported no transactions.

¹² IMF. [Public Enterprises and Fiscal Risks in Nepal](#). 2023.

¹³ The government's investment in public enterprises (share and loans combined) rose to 12.3% of GDP in FY2024 from 10.2% in FY2014. [Source: The World Bank. 2025. Nepal Development Update].

while most public services are delivered by SNGs. As a result, SNGs are left with expanded mandates but inadequate resources. SNGs also suffer from weak institutional capacity and ineffective planning and budgeting, leading to poor resource planning and management. The following factors contribute to these challenges:

- (i) **Limited revenue sources and weak revenue administration capacity.** While significant expenditure responsibilities have been devolved to SNGs, revenue sources assigned to them are limited as high-yielding revenue sources such as income tax, value-added tax, and customs duty (which together constitute more than 85% of total revenue) are assigned to the federal government. Hence, SNGs rely heavily on central transfers to meet their expenditure needs, with own-source revenue contributing about 5% of total receipts in FY2023. Property tax,¹⁴ one of the exclusive revenue sources assigned to local governments or municipalities, is poorly collected because of weak institutional capacity. The absence of a framework and guidelines for objectively valuating properties based on location, size, and economic potential has also constrained revenue mobilization from property tax.
- (ii) **Inadequate financing and lack of strong local capital market.** Public investment needs of SNGs for local economic development and effective public service delivery are significantly higher than available financial resources. Also, while SNGs are allowed to borrow funds domestically for capital investments, the country lacks a regulatory framework and domestic capital market. Blended finance and innovative financing mechanisms to mobilize funds from different sources, including bonds and equity investments, are not fully explored and exploited at the SNG levels.
- (iii) **Disconnect between planning and budgeting.** Another major PFM problem for SNGs is the disconnect between planning and budgeting. The inclusion of new projects in the annual budget before the completion of ongoing projects reflect weak planning and insufficient budget allocation for completion of the ongoing projects. The budget is not based on realistic assumptions, resulting in an overestimation of expenditure or a shortage of funds. Public investment management in SNGs is also weak and lacks a pipeline of ready-to-improve and bankable projects. The absence of transparent criteria for project selection and financing leads to spending in nonprioritized areas and on projects considered mostly on political grounds without any cost-benefit analysis.
- (iv) **Infrastructure not accounted for in asset management system.** Although the public asset management system (PAMS) was rolled out to provincial governments under subprogram 1, it does not account for infrastructure. Hence, physical assets are often neglected and not regularly maintained. This reduces the life of those assets, requiring additional financial resources to develop new assets.
- (v) **Lack of knowledge and technical assistance in deriving revenue from natural resources.** Natural resources with revenue-generating potential are under the jurisdictions of SNGs. However, a lack of knowledge about such resources and mechanisms to generate revenue from them constrains the ability of SNGs to exploit them. Further, ineffective coordination among government tiers (for concurrent functions and authorities related to natural resources) hinder them from generating revenues.

¹⁴ Property tax is globally recognized as a stable and reliable source for local governments. In Nepal, property tax is levied on land and buildings based on assessments, which consider factors such as location, land size, and built-up area in determining the rate. However, these assessments are often ad hoc, inconsistent, and disconnected from market values in the absence of a national property valuation standard.

10. **Strategic alignment.** Subprogram 2 is aligned with the government's 16th Plan (footnote 7). It will support 3 of the 13 priority areas: (i) consolidation of provincial and local economies and balanced development, (ii) enhanced effectiveness of PFM and capital spending capacity, and (iii) governance reforms. Subprogram 2 will also contribute to three other areas related to strengthening macroeconomic fundamentals: gender equality, poverty reduction, and climate change. Further, Subprogram 2 is aligned with pillar 2 (promote inclusive and quality human capital development and public services) of ADB's country partnership strategy for Nepal, 2025–2029.¹⁵ It also supports three of the five priorities or strategic focus areas of the Strategy 2030 midterm review: climate action, digital transformation, and resilience and empowerment, and two of the three development results: people and prosperity.¹⁶

B. Policy Reform, ADB's Value Addition, and Sustainability

11. **Policy reform.** Subprogram 2 builds on the reforms implemented under subprogram 1 (para. 2), which laid the foundation for two reform areas: (i) improved expenditure and debt management at the national level and (ii) improved resource planning and management at the subnational level. Out of the 10 indicative policy actions (including 16 sub-actions) for subprogram 2 agreed by the government at the time of subprogram 1 approval, 1 action has been further strengthened while 1 action and 4 sub-actions have been modified as follows:

- (i) **Policy sub-action 2.1(ii).** The scope of this sub-action on operationalizing the fiscal risk and strategy report and reporting to a Parliament committee any departure from the strategy was revised to cover only the operationalization of the fiscal risk and strategy report. Since this is the first report ever prepared, the deviation can be assessed only next year (after a year of its operationalization). So, a deviation report for the parliament committee shall be prepared under the Post-Program Partnership Framework (PPPF).
- (ii) **Policy sub-action 2.2(i).** This sub-action on the Public Debt Management Office (PDMO) accounting for contingent liabilities of public enterprises and public–private partnerships (PPPs) was revised to the contingent liabilities of public enterprises only (not PPP projects) as the PDMO does not have the legal mandate to oversee PPPs.¹⁷ This sub-action was replaced by the development of guidelines on the assessment of contingent liabilities of state-owned enterprises. The guidelines were needed for a more standard and objective approach to determining the liabilities and understanding debt more clearly.
- (iii) **Policy action 2.3.** This policy action was strengthened by adding a new sub-action on upgrading the public enterprises management information system (PEMIS), which provides financial and non-financial information on public enterprises in real time. Thus, it contributes to enhanced monitoring, reporting, and corporate governance of public enterprises.
- (iv) **Policy sub-action 2.4(i).** This sub-action on upgrading the electronic government procurement (e-GP) system and linking it with the government's budgeting and

¹⁵ ADB. 2025. [*Country Partnership Strategy: Nepal. 2025–2029—A Partnership for Private Sector-Led Growth, Youth Employment, and Resilience.*](#)

¹⁶ ADB. 2018. [*Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*](#); and ADB. 2024. [*Strategy 2030 Midterm Review: An Evolution Approach for the Asian Development Bank*](#).

¹⁷ Because the PDMO is responsible for all public debt, contingent liabilities of PPP projects were included. However, PDMO clarified during implementation that the Investment Board is responsible for PPP projects, so they were removed from the policy action.

accounting (unified IT) system was replaced by Integrated PFM System (IPFMS)¹⁸ because of the delay in upgrading the e-GP system. The IPFMS serves as the backbone of the government's financial operations and management, and ensures seamless data exchange among government agencies, which contributes to coordinated fiscal planning, management, reporting, and improved fiscal discipline.

(v) **Policy action 2.6.** The Cabinet approval of the TDF Bill for submission to Parliament was replaced by the Cabinet approval of the Alternative Development Finance Mobilization (ADFM) Bill for submission to Parliament as a concept note and regulations also had to be prepared and submitted along with the TDF Bill but preparation of these was not feasible in the given timeframe. The replaced policy action is similar to TDF Bill as ADFM Bill provides for the mobilization and financing of capital investments through the establishment of the ADFF. The main difference is that the TDF focuses on SNGs whereas the Alternative Development Finance Fund (ADFF) will support both national and subnational governments.

(vi) **Policy sub-action 2.10(i).** The scope of this sub-action was narrowed from developing objective valuation criteria and revising property tax rates (by the selected municipalities) to developing only valuation criteria as revising property tax rates would require further consultations, public communication strategies, and agreement from elected municipal representatives.¹⁹

12. These changes, however, did not change the policy objectives and expected development outcomes of the program.

13. **Reform area 1: Expenditure and debt management improved.** The fiscal reforms implemented under subprogram 1 were continued under subprogram 2 to improve and institutionalize expenditure and debt management and reduce fiscal risks. To achieve the policy objective, the Ministry of Finance (MOF) prepared and approved the fiscal risk and strategy report for FY2025–2026 on 30 July 2025, and was operationalized through the annual budget operation guidelines for FY2026.²⁰ The report includes fiscal risks (from six key sources),²¹ which would reduce fiscal space for productive capital investments, increase the cost of borrowing and inflationary pressure, and reduce investor's confidence leading to economic instability. It also includes strategies to address those risks, which will enhance the macro-fiscal framework, promote accountability, and reduce public debt. Further, the MOF approved guidelines on the contingent liabilities of state-owned enterprises on 7 October 2025, which provides a systematic approach to the analysis, measurement, and disclosure of contingent liabilities in line with Nepal Accounting Standards. PDMO compiled and published the contingent liabilities of state-owned enterprises (by sector on an aggregated basis) in a semiannual public debt bulletin, which has improved understanding of public debt and enhanced transparency. As mandated by the Public Debt Management Act (approved under subprogram 1), PDMO institutionalized the annual borrowing plan (ABP), which outlines the government's strategic plan to meet its gross financing

¹⁸ The PFM system has integrated the (i) computerized government accounting system, (ii) Treasury single account system, (iii) Treasury management system, (iv) project accounting management module, (v) commitment recording module, and (vi) internal audit module. Other systems are also being integrated, such as the revenue management information system, financial management information system, and PAMS.

¹⁹ As the local election is scheduled in 2026, the 10 municipalities proposed that consultations and preparation of public communication documents will be undertaken before the election, whereas property tax rates will be revised after the election. Ministry of Federal Affairs and General Administration supported this proposal.

²⁰ The MOF issues the budget implementation guidelines a few days after budget approval every year to translate the approved budget into actionable plans for spending agencies and to provide clarity on spending procedures and reporting.

²¹ The key sources of risks are (i) macroeconomic, (ii) natural hazard, (iii) subnational governments, (iv) government guarantees, (v) public enterprises, and (vi) PPPs.

needs and includes fiscal deficits and debt maturities. The ABP was published in FY2025 and FY2026.

14. To address the issues of poor governance and management of public enterprises, the Cabinet approved the Public Enterprises Management and Governance Policy on 28 September 2025. It provides clarity between ownership (which is primarily about control and accountability) and management (which relates to execution and performance), strengthens oversight and transparent decision-making, and improves performance management using key performance indicators. The Cabinet also approved a loan and share investment policy on 7 October 2024, which helps the government make more objective decisions on the investments in public enterprises. These policies were essential to improve the corporate governance, operations, and accountability of public enterprises; and to reduce the government's credit exposure to public enterprises. Upgrading the PEMIS, which includes financial and non-financial information of public enterprises, was an important and complementary institutional reform to improve monitoring of public enterprises' performance. To address operational inefficiencies and uncoordinated planning caused by the fragmented PFM system, the Financial Comptroller General Office (FCGO) operationalized a new PFM system (footnote 16) that integrated expenditure, revenue, treasury, project accounting, and internal audit management systems. Further, the National Planning Commission compiled and published a report on cost and time overruns of national priority projects for the first time,²² which improved understanding of the bottlenecks to the timely completion of projects, one of the causes of reduced capital expenditure. The Cabinet also approved the new PFM Reform Strategy (2025–2030) on 29 August 2025, which was informed by the findings of the latest gender- and climate-responsive PEFA assessments. It has seven strategic pillars ranging from budget execution to revenue management and auditing for the three tiers of government—a major step toward strengthening Nepal's PFM system. All policy actions in reform area 1 have been completed.

15. **Reform area 2: Subnational resource planning and management improved.** The reforms under reform area 2 are relevant for all SNGs. However, 10 local governments (municipalities)²³ from three provincial governments were selected to execute some of the reforms to validate their relevance and practical application. The reforms under subprogram 2 were built on the reforms implemented under subprogram 1 to improve and institutionalize the resource planning and management of SNGs. To address inadequate revenues for increased capital investments, the ADFF is proposed to be established with an authorized capital of NPR100 billion (approx. \$703 million) and a paid-up capital of NPR25 billion (\$176 million) under ADFM Bill, which was approved by the Cabinet for submission to Parliament on 9 October 2025.²⁴ Further, a model taxpayer registration system was developed for provincial governments, and a revenue module was operationalized through the Subnational Treasury Regulatory Application²⁵ in more than 40% (350 of 753) of urban and rural municipalities at the local level. This has made revenue administration more efficient, which will eventually increase revenues.²⁶ The revenue module (i)

²² National Pride Projects are a set of large-scale, high-priority infrastructure projects of the Government of Nepal based on their strategic importance to national development, as recommended by the National Planning Commission.

²³ The selected provinces were Bagmati, Gandaki, and Sudurpaschim. The selected municipalities were Banepa, Bharatpur, Byas, Godavari, Jagannath, Jwalamukhi, Naugad, PhediKhola, Pokhara, and Shailung.

²⁴ The primary objective of the Alternative Development Financing Fund (ADFF) is to mobilize investments for resilient infrastructure at national and subnational government levels and bridge the country's development financing gap. It aims to mobilize domestic and international capital through bonds, equity investments, and remittance pools among others.

²⁵ The Subnational Treasury Regulatory Application is a digital financial management system designed to support budget execution, accounting, and reporting for local governments.

²⁶ The provincial tax registration system will be able to generate statutory reports, compliance reports, and analyzable databases for revenue management. It includes five core functional modules: (i) payment management, (ii) receipt

enables local governments to forecast and plan revenue sources, (ii) monitors revenue collection in real time, (iii) generates revenue reports, and (iv) allows performance analysis of different revenue heads. Further, the PAMS upgrade to record infrastructure assets (and its operationalization in 10 selected municipalities) has supported the development of a comprehensive inventory and valuation of public assets resulting in more effective public investment planning and decision-making.

16. To address ineffective planning and the disconnections between local plans and budgets, policy and institutional reforms implemented in the selected municipalities included (i) the development and approval of gender- and climate-responsive medium-term expenditure frameworks (MTEFs), which helped to align municipal plans, projects, budgets, and fiscal projections; (ii) allocation of 10% of the annual budget for programs and projects that supported gender equality, women's empowerment, and social inclusion, which ensured that the development needs of women and marginalized groups were considered; and (iii) formulation and approval of the Project Bank Operation and Management Guidelines (in line with the national guidelines) for conducting due diligence in project selection and ensuring only technically sound, environment-friendly, and economically viable projects are included in the budget. Based on the guidelines, the 10 municipalities prepared project banks, which were approved by their respective executive committees. The implementation of these reforms demonstrated how strategic approaches to planning and investments improve the efficiency and effectiveness of resource allocation and strengthen the links between plans, projects, and budgets. The 10 municipalities also developed criteria and tools for objective assessment and valuation of properties, in line with the relevant laws and policies, including the Land Use Act, 2019. The criteria and valuation formula provide an empirical basis for municipalities to revise their property tax rates, which will increase their revenues.²⁷ Further, the 10 municipalities mapped natural resources (water, mountains, mines and minerals, and forest, as identified by the Government of Nepal) that have revenue-generating potential.²⁸

17. **Sustainability of reforms through post-program engagement.** A PPPF has been incorporated into the policy design and monitoring framework to institutionalize and sustain the reforms introduced through subprograms 1 and 2. The PPPF will be implemented for a year (from October 2025 to October 2026) through ADB's ongoing technical assistance (TA) for Supporting Strengthening Public Financial Management and Devolved Service Delivery Program,²⁹ Domestic Resource Mobilization Trust Fund, and other subprojects. The key implementing agencies and stakeholders of the PPPF will be different departments of MOF and municipalities (which will be determined in coordination with the Ministry of Federal Affairs and General Administration. The support will include (i) implementation of strategies to address fiscal risks, (ii) assessment of contingent liabilities of selected public enterprises and capacity development of PDMO staff, (iii) preparation of a road map for public enterprises reform, (iv) integration of other independent PFM

management, (iii) web portal for tax (for taxpayers), (iv) access to external system (for audit purposes and data exchange), and (v) master data management (database). The system is aligned with the federal tax system and uses the same tax registration system with unique personal account numbers for taxpayers.

²⁷ The criteria include (i) the location of the property (such as proximity to commercial centers and transportation hubs); (ii) road access and quality (highways, internal roads, and paved roads); (iii) land use (residential, commercial, and industrial); (iv) shape and size of land; (v) building structure (load bearing); and (vi) size, use (residential, commercial), and age of buildings. Based on these criteria, a formula was recommended to compute the valuation.

²⁸ The natural resources include 6,000 rivers with capacity to generate more than 32,000 megawatts of electricity, 468 peaks above 5,000 meters, forests covering 46% of the country's landmass, and 636 kinds of minerals. Data was sourced from (i) Water and Energy Commission Secretariat, (ii) Department of Electricity Development, (iii) Nepal Mountain Academy, (iv) Department of Forests and Soil Conservation, and (v) National Statistics Office.

²⁹ ADB. 2023. *Supporting Strengthening Public Financial Management and Devolved Service Delivery Program (Subprogram 1)*.

systems with IPFMS, and (v) implementation of the PFM Reform Strategy. Under the second reform area, PPPF support will include (i) setting up of an institutional mechanism for ADFF, including safeguard assessment tools, (ii) development of a provincial taxpayer registration system, (iii) training for municipalities on preparing MTEFs and project banks, (iv) rollout of property valuation criteria and tools to other municipalities, and (v) mapping of natural resources with revenue-generating potential in other municipalities and provinces.

18. **ADB's value addition.** The program is anchored on the policy and institutional support and dialogue with the government, ADB's upstream knowledge work, and lessons from past engagements. ADB supported the establishment of the PDMO, drafting of the debt management bill, and installation of the debt operations and management system.³⁰ The program built on these reforms to improve debt management and reduce fiscal risks. The reforms on resource planning and management by SNGs follow previous policy-based lending and TA support on strengthening PFM,³¹ as well as technical studies on governance and institutional challenges and risks in Nepal³² and fiscal federalism.³³ ADB's regular policy dialogue—bilaterally and jointly with other development partners³⁴ with the MOF on fiscal management and with the Ministry of Federal Affairs and General Administration on local PFM reforms have been instrumental in pursuing the reforms under the program, particularly in developing the new PFM Reform Strategy and integrated PFM system. In coordination with the IMF, ADB also provided TA support (footnote 27) to (i) undertake fiscal risks assessments; (ii) analyze time and cost overruns of national priority projects; (iii) provide technical inputs and capacity development support for the preparation of contingent liabilities guidelines, taxpayer registration system, MTEF, and project banks; and (iv) map out natural resources with revenue-generating potential. ADB's Domestic Resource Mobilization Trust Fund provided technical and financial assistance for a comprehensive assessment of Nepal's property tax system and formulation of property valuation criteria and methodology. Another ADB TA operation³⁵ provided policy research, analysis, and consultation support for the preparation of the uniform policy for public enterprise management and governance, as well as upgrading of the PEMIS. Several orientation sessions, stakeholder consultation workshops, and capacity development events were organized under the TA projects to support policy implementation.

19. The innovative aspects of the program include (i) strengthening fiscal federalism by engaging with SNGs on implementing policy and institutional reforms despite weak institutional capacity; (ii) developing the first fiscal risk strategy report to identify and address fiscal risks; (iii) pursuing public enterprise reforms to improve their corporate governance; (iv) expanding digitalization and integration of PFM systems for increased operational efficiency, effective coordination, and greater accountability and transparency; and (v) mapping natural resources with revenue-generating potential in selected SNGs, which contributed to the Government of Nepal's plan for natural resources across the country. The government plans to apply the model for mapping other parts of the country.

³⁰ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to Nepal for the Capital Market and Infrastructure Capacity Support Project*.

³¹ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Grant, Administration of Grant, and Technical Assistance Grant to Nepal for the Strengthening Public Management Program*; and ADB. 2016. *Technical Assistance to Nepal for Strengthening Subnational Public Management*.

³² R. Shrestha. 2019. *Governance and Institutional Challenges and Risks in Nepal*. ADB.

³³ ADB. 2022. *Strengthening Fiscal Decentralization in Nepal's Transition to Federalism*.

³⁴ ADB is a member of international development partners' group and PFM working group.

³⁵ ADB. 2021. *Improving Infrastructure and State-Owned Enterprise Governance for Sustainable Investment and Debt Management*.

20. **Lessons and sustainability.** Lessons from ADB's previous PFM programs include the following: (i) long-term engagement is essential to achieve sustainable PFM reforms and secure political commitment, as short-term interventions and isolated efforts rarely deliver results; (ii) Nepal's transition to federalism has devolved power to local governments, but capacity gaps in SNGs hinder effective public service delivery; and (iii) weak public institutions slow the reform process and implementation of development projects and programs, leading to low capital expenditure and thereby impact economic growth.³⁶ Coordination with other development partners and discussions with relevant stakeholders, such as community organizations, private sector, think tanks, and civil society organizations, informed the formulation of the policy actions. For instance, subnational reform priorities were coordinated with other development partners to avoid duplication and consolidate efforts to advance fiscal federalism. The outcome indicators are consistent with the objectives of the policy reforms and the government's commitment, as outlined in the strategy or plan for that area. The proposed program is aligned with the government's priorities, helping ensure the sustainability of reforms. To prevent any rollback of policy reforms, ADB has built continued engagement with the government into TA projects and policy dialogues, conducted both bilaterally and jointly with development partners. Accordingly, the program has incorporated PPPF to take forward the reform initiatives and facilitate their institutionalization so that the policy reforms are sustained (para. 17).

21. **Development coordination.** ADB and other development partners coordinate development activities and the reform agenda through high-level International Development Partner Group meetings.³⁷ The government and development partners discuss development priorities and support during annual portfolio review meetings led by the government. ADB also engages with sector and thematic working groups, such as the Federalism Working Group, PFM Working Group, and Gender Working Group, to ensure complementarity and avoid duplication of support. A World Bank-administered PFM multi-donor trust fund, financed by several development partners, is providing TA to the government for initiatives including PEFA assessment, capacity development, digitalization, and diagnostics studies on PFM issues. In addition to coordination with the World Bank on reforms included in the two banks' budget support operations, ADB closely coordinated with the IMF's Extended Credit Facility Program to align reform objectives and actions with the IMF program.³⁸

C. Expected Outcome of the Reforms

22. The program's impact will be improved fiscal sustainability and fiscal federalism (aligned with Nepal's overarching development objectives in the 16th Plan). The program outcome is improved fiscal planning and management by national and subnational governments. The program contributed to achieving this outcome (paras. 23 and 24).

23. The reforms on fiscal risk strategy, contingent liabilities, debt bulletins, and annual borrowing plans will inform the design of fiscal policies that are resilient to potential future shocks and responsive to fiscal risks. This will improve the macro-fiscal framework, fiscal discipline, and transparency. The institutionalization of ABP will help maintain the public debt-to-GDP ratio within 50% (in line with the medium-term debt management strategy). The reforms related to governance and accountability of public enterprises will reduce the share of loss-making public

³⁶ ADB. 2019. [*Technical Assistance Completion Report: Strengthening Subnational Public Management in Nepal*](#) and ADB. 2021. [*Completion Report: Capital Market and Infrastructure Capacity Support Project in Nepal*](#).

³⁷ The group meets with the government authorities periodically and holds policy dialogue on various development issues.

³⁸ A policy action on a fiscal risk and strategy report complements the reform agenda of the [*IMF's Extended Credit Facility*](#) on the development of a fiscal register and publication of a fiscal risk statement.

enterprises from 47% in FY2021 to 30% by September 2026. These reforms enable more rational policy decision-making on public spending and reduce the credit exposure of governments. The IPFMS is another vital institutional reform that will improve operational efficiency, coordinated resource planning, fiscal transparency, and reporting. It will also contribute to paperless administration, supporting environmental protection. Further integration of independent PFM systems can now be undertaken smoothly. The PFM Reform Strategy and consolidated reports on national priority projects will (i) streamline PFM reforms at all government levels; (ii) support objective monitoring and evaluation through targets and indicators in the PFM Reform Strategy; and (iii) contribute to increased capital expenditure or budget absorption, which has been critically low for several years. Capital budget absorption is expected to increase from 57.2% in FY2022 to 70.0% by September 2026.

24. The establishment of the ADFF under its own legislation (Alternative Development Finance Mobilization Bill) is a crucial policy and institutional reform that would provide cost-effective debt financing support to national and subnational governments. This will contribute to economic growth through increased capital expenditure. The institutional reforms through the taxpayer registration system in provinces and the operationalization of the Subnational Treasury Regulatory Application's revenue module will expand the digital database of taxpayers, enhance operational efficiency in revenue administration, improve tax compliance, and increase own-source revenue. At least 100,000 taxpayers are expected to be registered by September 2026. Similarly, the upgraded PAMS will improve the life cycle of infrastructure assets and their resilience. The revenue-generating potential of those assets can also be assessed and appropriately used. Further, local gender- and climate-responsive MTEFs, the 10% budget allocation to support gender equality and social inclusion, and project banks are other important initiatives for local governments to learn the mechanics of effective planning and increase allocative efficiency. These will also contribute positively to social, economic, and environmental impacts, as well as increase value for money. The property valuation criteria and mapping of natural resources will help local governments identify and tap new revenue sources, increasing the share of own-source revenue from 10.3% in FY2020 to 14.0% by September 2026. This will eventually reduce SNGs' reliance on fiscal transfers from the federal government.

D. Development Financing Needs and Budget Support

25. The government's development financing need for FY2026 is estimated at \$4.3 billion based on its projected budget deficit for the fiscal year. External financing (foreign loans) will cover 39.5% of the deficit (\$1.7 billion), while foreign grants and domestic borrowing will fund the balance.³⁹ The government has requested a concessional loan of \$100 million from ADB's ordinary capital resources to finance subprogram 2, which accounts for 6% of overall external financing needs. The loan will give the government fiscal space to implement reforms identified by the program at a time when revenue collection has been unstable for various reasons, including the recent civil unrest and political volatility, and reduced inflow of foreign grants. The loan will have a 24-year term, including a grace period of 8 years, an interest rate of 1% per year during the grace period and 1.5% per year thereafter, and such other terms and conditions set forth in the draft loan agreement. Of the subprogram 2 amount, total climate finance is \$17.5 million, including \$13.0 million as climate adaptation finance and \$4.5 million as climate mitigation finance.

³⁹ Of the \$1.7 billion in external financing for FY2026, the government estimates that 48.6% (\$826.2 million) will come from ADB, 30.9% (\$525.3 million) from the World Bank, and 4.8% (\$81.6 million) from the IMF.

E. Implementation Arrangements

26. The MOF's Budget and Program Division is the executing agency for the program. The implementing agencies are FCGO, MOF, Ministry of Federal Affairs and General Administration, National Planning Commission, and PDMO. A program steering committee, chaired by the head of the Budget and Program Division, oversaw and coordinated program implementation. The steering committee met semiannually and whenever needed to monitor progress and provide guidance for the timely implementation of the policy actions. Subprogram 1 was implemented from May 2021 to August 2023; subprogram 2 was implemented from September 2023 to October 2025. The proceeds of the policy-based loan will be withdrawn following ADB's *Loan Disbursement Handbook* (2022, as amended from time to time) and detailed arrangements agreed between the government and ADB.

III. DUE DILIGENCE

27. **Safeguards.** In compliance with ADB's Safeguard Policy Statement (2009), the program is classified C for environment, involuntary resettlement, and Indigenous Peoples' safeguards.⁴⁰ A matrix of potential environmental and social safeguards impacts was prepared to assess each policy action. The assessment confirms that policy actions under subprogram 2 related to improved expenditure and debt management by the national government do not have direct nor indirect environmental and social safeguards impact. Policy actions 2.6 (ADFM Bill) and 2.9 related to enhanced resource planning and management by SNGs may result in downstream investment with environmental or social impacts through the ADFF, MTEF, or project banks. The mapping of natural resources for generating fiscal revenues for municipalities, as outlined in policy action 2.10, has been approved. Direct impacts are not anticipated, and indirect impacts can be managed through the application of national laws and regulations with guidelines requiring environmental assessments to be completed before projects are considered for prioritization. Linked to the future use of natural resources as part of the PFM reforms in policy action 2.5, PPPF support should be provided to ensure that laws protecting natural resources from overexploitation are not weakened. No works or pilot activity is envisaged under the program as the policies focus on organizational and financial reforms. While downstream impacts may occur in relation to policy actions 2.5, 2.6, and 2.9, these can be effectively managed through screening and appraisal procedures that comply with national environmental and social regulations. These include safeguarding Indigenous Peoples' rights, embedding environmental and social assessments in project planning, and increasing the capacity of local governments to implement safeguards. For policy action 2.6 on Alternative Development Finance Mobilization Bill, development of implementing rules and regulations, policies, procedures and guidelines for safeguard measures will be progressed under the PPPF with ADB TA support.

28. **Poverty and social inclusion.** Though Nepal reduced extreme poverty⁴¹ from 55% in 1995 to 0.37% in 2023,⁴² the domination of low-productivity economic activities, inadequate and inefficient public spending, and weak public service delivery continue to hinder sustained poverty reduction.⁴³ These achievements are noteworthy despite political volatility, structural challenges,

⁴⁰ ADB classifies projects into safeguards categories (A, B, C, or F) based on significance of potential environmental, involuntary resettlement, and Indigenous People's impacts. Category C projects are likely to have minimal or no adverse impacts.

⁴¹ Defined by the \$2.15 per day threshold.

⁴² Asian Development Bank (ADB). 2025. *Country Partnership Strategy: Nepal, 2025–2029—Inclusive and Sustainable Growth Assessment*.

⁴³ Poverty and Social Impact Assessment (Annex 8). In 2022, 20.3% of the population lived below the poverty line. ADB. 2023. [Poverty Data: Nepal](#) (accessed 17 September 2025, and 04 November 2025).

and multiple disasters triggered by natural hazards. Reforms related to effective fiscal risk management, improved governance and performance of public enterprises, and implementation of ABP will contribute to macroeconomic stability and increased fiscal space, which will help address poverty and extend support to the social sector. The implementation of the PFM Reform Strategy, MTEF, and project banks will strengthen budget planning, execution, and equitable allocation of resources, as well as prevent abrupt funding shortfalls that affect the poor and vulnerable. Further, earmarking 10% of the budget for women and disadvantaged groups will directly support poverty reduction and social inclusion. Policies aimed at increasing own-source revenue through the revision of property valuation criteria and mapping of natural resources will facilitate increased social investments and the design of local pro-poor programs.

29. **Gender.** The program is categorized *effective gender mainstreaming* and includes steps to resolve some key gender issues. Building on the achievements of subprogram 1, subprogram 2 supports the following actions: (i) the Cabinet approved PFM Reform Strategy 2025–2030, derived from the 2025 gender- and climate-responsive PEFA assessment for identification and coordinated implementation of PFM reforms for sustainable fiscal planning and management; (ii) the model taxpayer registration system, disaggregated by sex, for the provincial governments to digitalize taxpayer details and increase efficiency in provincial revenue administration was developed and rolled out; and (iii) the executive committees of 10 municipalities approved (a) gender- and climate-responsive MTEFs for effective planning and budgeting; and (b) allocation of 10% of annual budgets for programs and projects that support gender equality, women's empowerment, and social inclusion.

30. **Climate change.** Nepal is prone to disasters driven by geology and climate change. Flood and drought hazards pose threats to human lives, livelihoods, and fiscal stability.⁴⁴ Policy actions that enhanced adaptation to climate-induced disasters included the development of a fiscal risk and strategy report, which identified natural hazards as a source of fiscal risk. This paved the way for the formulation of adaptation and mitigation policies, strategies, and action plans to address climate risks and impacts. Approval and implementation of the PFM Reform Strategy, derived from the 2025 gender- and climate-responsive PEFA assessment, helped embed climate goals in the PFM ecosystem. This reform was complemented by the formulation of climate-responsive MTEFs and the development of project banks with projects selected based on their economic, social, environment, and climate-resilient values by 10 municipalities. These enabled local governments to align climate goals with medium-term plans and help build climate-friendly infrastructure projects.

31. **Governance.** Nepal measures its PFM performance largely through the PEFA assessments. Most of Nepal's scores in the 2024 PEFA assessment were either C, which denotes basic level of performance, or D, which indicates less than basic level of performance. The PFM challenges include declining budget credibility, weak monitoring of public investment, insufficient information to objectively assess fiscal risks, inefficient procurement planning, fragmented public asset management, and absence of compliance improvement plans for revenue entities.⁴⁵ As per the subnational PEFA assessments conducted in two provinces, the need for PFM system improvements are more acute at the subnational level as PFM systems and practices there are weaker compared to the federal level. The program has helped address some of these challenges through measures such as (i) preparing a fiscal risk and strategy report; (ii) recording contingent liabilities of public enterprises; (iii) introducing policies on governance, management, and loan

⁴⁴ ADB and the World Bank. 2021. *Climate Risk Country Profile: Nepal* (accessed 17 September 2025).

⁴⁵ Footnote 8, pp XXIII.

and share investment of public enterprises; (iv) integrating PFM systems; and (v) adopting a medium-term PFM Reform Strategy.

32. Major risks and mitigating measures are summarized in the table.

Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Political volatility and ineffective intergovernmental coordination mechanisms could delay consensus and buy-in for reforms, negatively impacting the overall pace and success of policy implementation.	ADB will continue to engage with the interim government and elected government (post-election) in coordination with the development partners to continue and sustain the reform initiatives. Also, as per the Federal, Provincial, and Local Level (Coordination and Interrelation) Act, 2020, the Government of Nepal is committed to regularly meet for effective coordination.
Leakages and discretionary practices in tax collection and customs administration resulting in revenue losses, and erosion of taxpayer confidence.	MOF plans to expand automation of tax and customs processes and implement reforms outlined in the Domestic Revenue Mobilization Strategy 2024 to minimize leakages. ADB will also support MOF through its TA.

ADB = Asian Development Bank, MOF = Ministry of Finance, PFM = public financial management, SNGs = subnational governments, TA = technical assistance.

Source: ADB and Ministry of Finance.

33. ADB's Anticorruption Policy (1998, as amended from time to time) was explained to and discussed with the government.

IV. ASSURANCES

34. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the draft loan agreement. No disbursement shall be made unless ADB is satisfied that the government has completed the policy actions specified in the policy matrix relating to the program.

V. RECOMMENDATIONS

35. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank and recommend that the Board approve the loan of \$100,000,000 to Nepal for subprogram 2 of the Strengthening Public Financial Management and Devolved Service Delivery Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per year during the grace period and 1.5% per year thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masato Kanda
President

POLICY DESIGN AND MONITORING FRAMEWORK
NEPAL: PROPOSED STRENGTHENING PUBLIC FINANCIAL MANAGEMENT AND DEVOLVED SERVICE DELIVERY
PROGRAM (SUBPROGRAM 2)

<p>Country's Overarching Development Objective: Fiscal sustainability and fiscal federalism improved.^a</p>			
<p>Outcome: Fiscal management at national and subnational government levels improved.</p>		<p>Risks and Critical Assumptions</p> <p>R: Political volatility and ineffective intergovernmental coordination mechanisms could delay consensus and buy-in for reforms, negatively impacting the overall pace and success of policy implementation.</p> <p>R: Inadequate capacity of subnational governments to prevent and address corruption could result in weak enforcement and increased vulnerability to corrupt practices.</p> <p>A: Sustained commitment of the government for policy reforms.</p>	
Prior Actions: Subprogram 1 Completed (May 2021– August 2023)	Policy Actions: Subprogram 2 (September 2023–October 2025)	Outcome Indicators	Post-Program Partnership Framework (Oct 2025–Dec 2028)
<p>Reform Area 1: Expenditure and debt management improved</p>			
1.1. (i) Finance Minister issued a policy directive on 20 October 2022 to institutionalize fiscal policy statement as a part of the annual budget report effective FY2024 to enhance transparency and credibility of fiscal policy and budget estimates; and (ii) in preparation for implementing the policy directive, MOF issued fiscal policy statement for FY2023 in November 2022.	2.1. MOF prepared and approved an annual fiscal risk and strategy report ^b for FY2025–2026 on 30 July 2025 and operationalized it through annual budget implementation guidelines for FY2026 ^c to promote accountability, enhance macro-fiscal framework, and manage fiscal risks emanating from macroeconomic volatility, subnational governments, guarantees, natural hazard, public enterprises, and public–private partnerships projects.	<p>By October 2026</p> <p>a. Capital budget absorption increased to 70% of budgeted capital expenditure (FY2022 baseline: 57.2%) (Source: FCGO annual consolidated financial statement) [DR:1- People; SDG: 1.4]</p> <p>b. Public debt limited to 50% of GDP as targeted in MTDS (FY2022 baseline: 42.6% of GDP) (Source: Semiannual public debt report by PDMO) [DR: 3-Prosperity; SDG: 17.4]</p> <p>c. Contingent liabilities of 20% of the PEs are assessed and recorded.</p>	<p>(i) MOF will implement strategies to reduce fiscal risks for sustainable fiscal planning and management.</p> <p>(ii) PDMO will assess contingent liabilities of selected PEs to get accurate data on liabilities for effective debt management.</p> <p>(iii) MOF will prepare a road map on public enterprises reform to reduce fiscal risks from loss-making PEs and improve overall PE governance and finance.</p> <p>(iv) FCGO will integrate other PFM modules or independent PFM systems to IPFMS to further enhance the operational efficiency, planning, and coordination among all government agencies and tiers.</p>
1.2. (i) The parliament approved Public Debt Management Act (PDMA) in September 2022; and (ii) MOF approved MTDS FY2022–FY2024 effective June 2022 and commenced its implementation from FY2023 including (iii) operationalization of Debt Office Management System (DOMS) by PDMO for internal and external debt transactions to improve debt management and strengthen macro-fiscal framework.	2.2. Following the PDMA 2022, (i) MOF approved Policy Guidelines on the Assessment of Contingent Liabilities of State-owned Enterprises ^d on 7 October 2025; (ii) PDMO published contingent liabilities of state-owned enterprises, by sector on an aggregated basis, in the semiannual public debt bulletin to improve fiscal transparency and accounting of public debt; and (iii) following MTDS, PDMO implemented ABP ^e starting FY2025 and published ABPs in FY2025 and FY2026 to improve expenditure planning and effectively manage debt and fiscal risks.		

16 Appendix

<p>1.3. The Cabinet approved a Public Enterprises Restructuring Committee, with 33% women representation, effective April 2023 that will prepare an overall strategy for effective management of all public enterprises.</p>	<p>2.3. The Cabinet approved and MOF commenced implementation of (i) a uniform policy on public enterprises management and governance^f on 28 September 2025; (ii) loan and share investment policy^g for public enterprises on 7 October 2024, based on the recommendations of the PE Restructuring Committee for expenditure rationalization and improved governance of public enterprises; and (iii) MOF approved and operationalized PEMIS^h for enhanced recording and reporting of financial and non-financial information of public enterprises.</p>	<p>[FY2022 baseline: 0; Source: Debt bulletin] [DR: 3-Prosperity; SDG: 17.4]</p> <p>d. All government borrowing (external and internal) managed through DOMS following the ABP (FY2022 baseline: not applicable [DOMS not operationalized and ABP does not exist yet]) (Source: Report by PDMO) [DR: 3-Prosperity; SDG: 17.4]</p>	<p>(v) MOF will implement PFM Reform Strategy for improved and resilient fiscal planning and management and ensure that laws in relation to natural resources are not weekend.</p>
<p>1.4. (i) PPMO issued and commenced implementation of e-GP road map effective November 2022 and the Cabinet approved e-GP guidelines effective June 2023 to enhance public procurement including contract management; and (ii) PPMO issued a policy directive effective July 2023, following Public Procurement Act 2007, to line ministries to mainstream contract management as a part of the e-GP portal reporting system.</p>	<p>2.4. (i) FCGO operationalized an Integrated PFM System by integrating independent PFM systems on treasury, government accounting, project accounting, internal audit, and commitment recording to enhance operational efficiency in relation to planning, budget execution, treasury management, and financial reporting; and (ii) NPC published a report on cost and time overruns of priority projects (“national pride projects”) to promote expenditure transparency and accountability.</p>	<p>e. % of loss-making public enterprises decreased to 30% (FY2021 baseline: 47%) (Source: MOF annual budget report and Yellow Book) [DR: 1-People; SDG: 8.3]</p>	
<p>1.5. Budget and Programme Division integrated and operationalized effective October 2022, following a ministerial directive in FY2022 budget speech, a unified IT system by linking Line Ministry Budget Information System (LMBIS) and Provincial Line Ministry Budget Information System (PLMBIS) to improve expenditure allocation and control system.</p>	<p>2.5. The Cabinet approved and MOF began implementation of PFM Reform Strategy 2025–2030, on 29 August 2025, derived from the gender-ⁱ and climate-responsive PEFA assessment, 2024 to strengthen expenditure management and governance.</p>	<p>f. At least two independent IT PFM systems are integrated into the Integrated PFM System. (FY2022: not applicable [Integrated PFM System not yet developed]) (Source: Report by FCGO) [DR: 3-Prosperity; SDG: 16.6]</p>	
<p>Reform Area 2: Resource planning and management at subnational level improved</p>			
<p>1.6. The restructuring strategy of the Town Development Fund, with a widened mandate and increased capital structure for increased investments in subnational governments, is approved by the Cabinet in May 2023.</p>	<p>2.6. The Cabinet approved the Alternative Development Finance Mobilization (ADFM) Bill^k for submission to Parliament on 9 October 2025 to legally establish the Alternative Development Financing Fund (ADFF) to bridge the financing gap in developing resilient infrastructure and improving public service delivery by mobilizing domestic and international capital.</p>	<p>By September 2026</p> <p>g. Own-source revenue of local governments supported under the program increased to 14% of the total revenue of the respective local governments</p>	<p>(i) MOF will develop an institutional structure, including constitution of the oversight authority (e.g., Board) and governance mechanism, such as decision-making (including environment and social safeguard pre-requisites) for</p>

<p>1.7 The Cabinet approved an action plan on federalism implementation on 14 October 2022 and formed an Administrative Coordination Council on 10 March 2023 to implement the recommendations of a special parliamentary committee endorsed by the National Assembly to strengthen governance and devolved service delivery.</p> <p>1.8 All seven provinces operationalized the public asset management system (based on the PAMS guidelines issued by the FCGO) for effective management of assets.</p>	<p>2.7 (i) MOF developed and rolled out model sex-disaggregated taxpayer registration system^l for the provincial governments to digitalize taxpayer details and increase efficiency in revenue administration at the provincial level. (ii) FCGO added a revenue module to the SuTRA™ system and 40% of the local levels operationalized the module by FY2025.</p> <p>2.8 FCGO upgraded PAMSⁿ to include infrastructure assets and 10 municipalities operationalized it for effective resource management and revenue generation.</p>	<p>(FY2020 baseline: 10.3% of the total revenue) (Source: Annual Report, Office of the Auditor General) [DR: 3-Prosperity; SDG: 17.1]</p> <p>h. At least 100,000 taxpayers from all local governments registered in the taxpayers' database (FY2020 baseline: 0) (Source: Annual Report, MOFAGA) [DR: 3-Prosperity; SDG: 17.1]</p>	<p>projects to be financed under the ADFF, for effective operation and management of ADFF whilst managing its potentially adverse impacts.</p> <p>(ii) MOF will develop an IT system as per the provincial taxpayer registration system architecture.</p> <p>(iii) MOFAGA will conduct capacity development programs to enhance the capacity of local governments in MTEFs and project banks for improved resource planning in local governments.</p> <p>(iv) MOFAGA will roll out property valuation criteria and tools to other municipalities for objectively increasing their revenues.</p> <p>(v) MOFAGA will coordinate with (selected) municipalities in mapping natural resources with revenue-generating potentials for increased own-source revenue of those municipalities.</p>
<p>1.9 MOFAGA issued a policy guideline effective May 2021 to local governments to prepare a 3-year gender responsive and climate change-responsive MTEF to (i) enhance linkages between policies, development projects, and budget; (ii) establish a foundation for outcome-based budgeting and inclusive resource planning, and (iii) include gender and climate change dimensions in the assessment of expenditure needs.</p>	<p>2.9 Municipal Executive Committees of 10 municipalities approved (i) gender and climate-responsive MTEFs for effective planning and budgeting^o; (ii) allocation of 10% of their annual budgets for programs and projects that support gender equality, women's empowerment, and social inclusion; and (iii) project bank guidelines for project selection, and (iv) based on the guidelines, 10 municipalities developed project banks^p with priority projects that were selected based on their economic, social, environment, and climate-resilient values (bankable projects) for improved allocative efficiency and public investment management.</p> <p>2.10 Municipal Executive Committees of 10 municipalities approved (i) objective property valuation criteria^q based on location, size, type, and economic potentials; and (ii) mapping of available natural resources with revenue-generating potentials for increasing fiscal space of local levels.</p>		
<p>Budget Support</p> <p>ADB</p> <p>Subprogram 1: \$100 million (policy-based loan)</p> <p>Subprogram 2: \$100 million (policy-based loan)</p>			

ABP = annual borrowing plan, ADB = Asian Development Bank, COVID-19 = coronavirus disease, DOMS = debt operations and management system, DR = Development Results, e-GP = e-government procurement, FCGO = Financial Comptroller General Office, FY = fiscal year, GDP = gross domestic product, GESI = gender equality and social inclusion, IPFMS = Integrated public financial management system, IT = information technology, LMBIS = Line Ministry Budget Information System, MOF = Ministry of Finance, MOFAGA = Ministry of Federal Affairs and General Administration, MTDS = Medium-term Debt Strategy, MTEF = medium-term

expenditure framework, NPC = National Planning Commission, PAMS = public asset management system, PDMO = Public Debt Management Office, PE = public enterprise, PEFA = public expenditure and financial accountability, PFM = public financial management, PLMBIS = Provincial Line Ministry Budget Information System, PPMO = Public Procurement Monitoring Office, R = risk, SDG = sustainable development goals, SuTRA = Subnational Treasury Regulatory Application.

Note: "Issued" refers to directive or guideline by an agency and is construed as commencing implementation.

- ^a Government of Nepal, National Planning Commission (NPC). 2024. [The Sixteenth Plan](#).
- ^b Fiscal risk and strategy report includes fiscal risks from six key sources that could impact the economic stability: (i) macroeconomic risks, (ii) natural hazard, (iii) subnational governments, (iv) government guarantees, (v) public enterprises, and (vi) public-private partnerships. The report includes detailed assessment of these risks and strategies to address those risks. The report is aligned with IMF's fiscal risk assessment report.
- ^c Budget implementation guidelines are issued annually to all expenditure units of the government after the approval of the annual budget. The guidelines provide details on eligible and ineligible expenditures; standards and measures that should be adopted in implementing the budget; mechanisms for transparency and accountability to be in place; implementation of different fiscal strategies, including the ones on fiscal risks; procurement procedures; and institutional arrangements, among others.
- ^d Contingent liabilities are potential financial obligations that may arise in the future, and which can pose significant fiscal risks, especially for governments that may be expected to intervene, e.g., loan guarantees issued by the government for public enterprises.
- ^e The ABP, prepared by the public debt management office, outlines the government's strategy in line with the medium-term debt strategy to meet its gross financing needs, which include the fiscal deficit and debt maturities—through a mix of domestic and external borrowing.
- ^f The uniform policy on the management and governance of public enterprises provide clear separation between ownership and management, strengthens board oversight, merit-based appointments in the board, transparent decision-making processes, and performance management using key performance indicators.
- ^g The loan and share investment policy helps government make more objective decision on the investments in public enterprises, and create uniformity in accounting practices, and thereby assess the accurate return on investments. The Policy includes strategies in terms of the nature of investments (e.g., equity investment, subsidized loan investment), where the government should not invest (e.g., multinational institutions, manufacturing of alcohol and tobacco etc.), ownership and institutional arrangements for investments (through the Public Debt Management Office), etc.
- ^h The PEMIS provides financial and non-financial information of (i) public enterprises with 50% government stake or more; (ii) public enterprises with less than 50% stake; (iii) bodies where the government has share and loan investments; (iv) pension and social security funds; (v) development committees engaged in commercial activities, and (vi) subsidiaries of public enterprises. The system includes institutional roles and workflow integration, comprehensive employee details, board of directors information, recruitment committee tracking, legislations, shareholding structure, asset management, and financial information management and reporting.
- ⁱ Gender responsive PEFA refers to an assessment of the extent to which Nepal's PFM system respond to differing needs of men and women, and intersectionality within these categories. It assesses how such PFM system promotes gender equality. It recognizes that "gender responsive budgeting requires PFM institutions, systems, and processes that are cognizant of gender differentiated needs and the differential impacts that fiscal policies and practices have on men and women." Climate-responsive PEFA refers to an assessment on the extent to which Nepal's "PFM system is ready to support and foster the implementation of government climate change policies." It covers laws and regulations, institutions, systems, procedures and processes and their contribution to the implementation of climate change activities throughout the budget cycle.
- ^j For reform area 2, the targeting of municipalities was based on factors such as demography, fiscal situation, human resources capacity, geographic distribution, etc. The program team was guided by the Ministry of Federal Affairs and General Administration for the selection of the municipalities under the PBL. Three provincial governments - Bagmati, Gandaki and Sudurpaschim were selected and 10 local governments/municipalities under these 3 provinces were selected. Implementation of the reforms in all 273 municipalities was not possible because of limited TA resources and the institutional capacity of the municipalities.
- ^k The Alternative Development Finance Mobilization Bill provides the legal basis for the establishment of the Alternative Development Financing Fund with an authorized capital of NPR100 billion and initial paid-up capital of NPR25 billion. It aims to mobilize domestic and international capital through bonds, equity investments, hybrid instruments, remittance pools, and guarantees.
- ^l The taxpayer registration system architecture represents a comprehensive digital infrastructure for provincial tax administration, and complies with the government of Nepal's regulatory framework such as Information and Communication Technology policy was developed, which includes (a) core functional modules – (i)

payment management, (ii) receipt management, (iii) web portal for tax, (iv) access to external system, (v) master data management, and (vi) tax structure and database; (b) access control; (c) personal account number uniqueness control check; (d) receipt reconciliation and data flow; and (e) dashboards and reporting.

^m SuTRA is a web-based financial management system developed for local governments to enhance their operational efficiencies in public financial management and improve transparency and accountability. It includes budget preparation, expenditure tracking, revenue collection, financial reporting, and grant utilization monitoring.

ⁿ The PAMS is a web-based digital system designed to record public assets across all public institutions in Nepal. The upgraded PAMS (version 2) include real time asset tracking and data integration across departments. It covers non-financial public assets, such as land and buildings, vehicles and machinery, medical equipment, and infrastructure (e.g., roads).

^o Gender and climate-responsive MTEF is a planning tool to align budget with development plans (over a three-year period) and programs/projects. Being gender responsive means it considers specific needs and impacts on women and marginalized groups. Climate-responsive refers to supporting climate adaptation and mitigation in sectors vulnerable to climate change. It includes gender and climate indicators.

^p Project bank is also a planning tool to prioritize development projects that are vetted (socioeconomic benefits) and costed based on the guidelines. It helps establish linkage between local government plans, projects, and budget and ensure that capital investments are objectively selected, appraised, and integrated into annual budgets based on development priorities and cost-benefit analysis.

^q Property valuation criteria refers to the calculation of minimum valuation rate of properties based on fit-for-purpose and locally appropriate market-based valuation protocols. The criteria includes key indicators for property valuation, such as location, shape, size, access to infrastructure, land use etc., and specific weightage is assigned to different indicators.

Source: ADB.