



Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 03-Oct-2017 | Report No: PIDISDSC22934



BASIC INFORMATION

A. Basic Project Data

Country Nepal	Project ID P164783	Parent Project ID (if any)	Project Name Integrated Public Financial Management Reform Project (P164783)
Region SOUTH ASIA	Estimated Appraisal Date Oct 20, 2017	Estimated Board Date Jan 15, 2018	Practice Area (Lead) Governance
Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance	Implementing Agency Ministry of Finance	

Proposed Development Objective(s)

Enhance the reliability and execution of the capital budget and strengthen financial reporting for efficient public expenditure management, greater transparency and stronger accountability in the new federal structure.

Financing (in USD Million)

SUMMARY

Total Project Cost	10.00
Total Financing	10.00
Financing Gap	0.00

DETAILS

Environmental Assessment Category
C-Not Required

Concept Review Decision
Track I-The review did authorize the preparation to continue



Other Decision (as needed)

B. Introduction and Context

Country Context

Over the past decade, Nepal's economy has performed reasonably well. Growth averaged 4.3 percent (at market prices) over 2005-15. Although declining as a share in the economy, agriculture continues to play a large role, contributing one third of value-added. The service sector has grown in importance, accounting for more than half of value-added in recent years. Industry in general, and manufacturing has grown more slowly and its relative share in the economy is falling. Similarly, exports continue to struggle, while imports are fueled by remittances that exceed 30 percent of GDP. Inflation was in single digits for most of the past decade, with the peg of the Nepalese rupee to the Indian rupee providing a nominal anchor. Fiscal balances remained sustainable owing to strong revenue growth and modest spending. The incidence of poverty measured against the national poverty line fell by 19 percentage points from 2003/04 to 2010/11, and in 2010/11¹, 25 percent of the population was counted as poor. Most multidimensional indicators of poverty also showed improvements across regions in Nepal. However, these gains remain vulnerable to shocks and setbacks, like the 2015 earthquakes which were followed by trade disruptions resulting in the lowest economic growth in 14 years in 2016.

Economic activity is rebounding strongly following the shocks, but risks are mounting. This rebound stems partly from a base effect, as well as a favorable monsoon boosting agricultural output and earthquake reconstruction gathering speed to raise investment. High inflation in the past two years has moderated sharply and has decelerated to 3.4 percent (y/y)² in May 2017. Government revenue continues to perform well, and spending has also picked up compared to previous years. Nevertheless, ambitious expenditure targets envisioned in the budget have not been met, leaving previously accumulated government deposits largely intact at NPR147 billion in May 2017. Meanwhile, rapid credit growth over the past year and slowing deposits are diminishing the availability of loanable funds. This has pushed up banks' credit to core capital plus deposit (CCD) ratios to 78 percent in January 2017 (the regulatory limit is 80 percent). Meanwhile, the cumulative effect of a sharp trade balance deterioration and a slow growth of remittances, has put the pressure on current account.

A new constitution that defined Nepal as a federal democratic republic was promulgated in September 2015. With the formulation of the new Constitution, Nepal is now migrating to a federal state structure with autonomous sub-national governments to be run by elected authorities. One major impact of the transition is the redundancy of the district offices and their sub offices to be replaced by Municipalities. The country will now have 7 Provinces and 744 Municipalities^[1]. Funds, functions and functionaries hitherto managed through the 75 District Development Committees will move to new local governments. While the proposed 744 Municipalities are expected to provide better outreach and services, they will likely take significant time to become fully operational.

¹ Recent data not available

² Year on year

^[1] Under the new Constitutions the 5 Development Regions and 75 districts have respectively been replaced by 7 States and 744 Municipalities (481 rural municipalities, 246 municipalities, 13 sub metropolitans and 4 metropolitans. The new States, however, are yet to be given official names.



Sectoral and Institutional Context

Nepal has taken significant strides in establishing a credible Public Financial Management system with the objective of ensuring a transparent, efficient, economical and accountable use of budgetary resources. Public financial management (PFM) is a key element of the Government of Nepal's (GoN) strategy for ensuring effective resource allocation, strengthening public service delivery, and creating inclusive and broad-based development. The PFM agenda has also been a top priority for development partners to promote efficient and effective public service delivery.

As part of its effort to strengthen the PFM system and coordinate the reforms, the GoN established a PFM Steering Committee and set up a Public Expenditure and Financial Accountability Secretariat in 2008. The first Public Expenditure and Financial Accountability (PEFA) Assessment was carried out in 2009 and formed the basis for a Public Financial Management Reform Program (PFMRP) Strategy, Phase I. The PFMRP 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. Building on the PFMRP I, a Multi-Donor Trust Fund (MDTF) was established by the World Bank and major development partners in 2010.³ The Nepal PFM MDTF has been assisting the GoN to modernize the PFM systems both through 1) supply side (Project with Ministry of Finance to modernize payments through a Treasury Single Account; upgrade audit systems through an intervention with the Office of the Auditor General; strengthening budget process for results ; and 2) demand side (to strengthen civil society engagement with the government's supply side services on PFM accountability) projects. These initiatives have paved the path to a successful first phase of PFM reforms in Nepal.

Nepal Strengthening Public Financial Management Reform (SPFM) and SPFM II projects were implemented under the Nepal PFM MDTF from 2011 to 2017. These two projects have been successful in implementing the Treasury Single Account (TSA) with closure of over 13,500 bank accounts. TSA has been rolled out across 75 districts in Nepal, which has led to a 100% coverage of the budget. Real time budgetary expenditures are available through the website of the Financial Comptroller General Office (FCGO), which has significant impact on the decision-making of the line managers. Monthly budget executions reports (Ministry wise, Spending District wise, Economic Classification wise) have been strengthened and are also available on a timely basis. A Revenue Management Information Systems (RMIS) was also established as part of these interventions. In addition to SPFM and SPFM II, the MDTF has supported interventions to support the Office of the Auditor General (OAG) and Citizens Engagement. There are two pipeline operations under the MDTF, one to continue the support to the OAG and the other for strengthening procurement. An IDA funded Development Policy Credit that includes PFM prior actions and triggers is also in a pipeline.

To sustain the ongoing PFM reforms in Nepal and promote effective and transparent public spending, the GoN conducted a second PEFA assessment in 2015 and prepared a PFM Reform Strategy/Program Phase 2 (FY 2016/17-2025/26). This second PFMRP has been divided into 119 major actions and 13 sub-projects based on relevant cluster of the required reform areas. The Government is currently working on the implementation of the second Reform Program. The future work program of MDTF and of other Development Partners will be based on activities identified in PFMRP II.

Despite all the initiatives to strengthen the PFM system, many challenges still persist at the federal level. Most of these challenges pertain to the 'basics', and therefore, will be the key target of the next phase of reforms. Dimensions with weak scores can be found in the 2015 PEFA. There is a need to consolidate PFM reforms at the federal level. PEFA

³ 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, Denmark, the Australian Government Department of Foreign Affairs and Trade (DFAT) and the United States Agency for International Development (USAID).



notes that the credibility of the budget is a concern as the variance of expenditure composition is significant. Supplementary budgets are provided to the line ministries if required. Predictability of flow of funds to the service delivery units, capital projects, and Subnational Governments (SNGs) is low, though under the new legislation, it is mandated to authorize the budget at predictable intervals, including availability of budget on the first day of the new fiscal year. The Ministry, Departments and Agencies (MDAs) do not submit reliable cash plans due to low capacity, though the templates have been designed. Commitment recording is being done ex-post, at the time of first payment of a contract at the District Treasury Controller Office (DTCO). The sub-vented agencies are on budget but off TSA. The recording of non-tax revenue through the RMIS has been expanded to all the 75 districts, though training and other capacity building is needed.

The consolidated financial statements are not prepared based on Nepal Public Sector Accounting Standards (NPSAS, which is aligned with IPSAS). However, financial statements based on NPSAS were prepared by 31 out of 44 central government line ministries for FY 2016/2017. There are some delays in preparing financial statements by the line ministries, which has an adverse effect on the country's consolidated financial statements. Many core government agencies, such as Autonomous Government Agencies (AGAs) and universities, are not consolidated into the main financial statements of the Government. The GoN provides substantial funding to public sector enterprises through its budgetary system by way of loans and grants. Due to inadequate reporting, GoN finds it a challenge to monitor fiscal risks arising from the State-Owned Enterprises (SOEs). The Institute of Chartered Accountants of Nepal (ICAN) has pronounced the roll-out of Nepal Financial Reporting Standards (NFRSs, are aligned with International Financial Reporting Standards) to SOEs, however compliance has been low due to capacity constraints.

Many Information Technology (IT) systems are used, in stand-alone, disintegrated mode, to record core financial management transactions. These systems were implemented to respond to the immediate challenges during the earlier phase of reforms, but now require an assessment to inform a coherent approach towards the establishment of an IFMIS platform. As reported in the PEFA, internal control and internal audit are key areas of concern. The Government has submitted a new Federal Financial Procedures Act to Parliament, and plans to revise Financial Procedures Rules, after the approval of the bill. The annual reports of the Office of the Auditor General (OAG) have repeatedly mentioned weak internal control and non-reliability of internal audit reports.

The move towards federalism has compounded the PFM challenges. There are many uncertainties in the country as new local governments are yet to be fully functional. There is no clear legal framework on PFM. There are no established PFM processes for intergovernmental or subnational level PFM activities. In addition, the weak PFM capacity at the subnational level constraints the management of funds at the local level along with the delivery of public services. This lack of systems, processes and capacity at the subnational level is likely to pose an immediate risk to public funds that have been allocated for the local governments. The Parliament is deliberating on four core bills relating intergovernmental fiscal transfers, allocation formula, Local Government Framework, and Staff Adjustments. Once passed these laws will lay out the landscape for PFM in the federal structure. Meanwhile to mitigate the immediate risks, the FCGO is in the process of defining reporting and fund flow mechanisms for the local governments. A harmonized and uniform chart of accounts aligned with GFS manual 2014 is under preparation for the federal and SNGs. Report formats are being designed accordingly and a basic budgeting and accounting system is under testing/development as an interim solution to meet immediate local governments' reporting requirements. Capacity building initiatives at local level will be needed to ensure compliance with these new requirements and to implement the new systems and processes. Develop Partners are currently restructuring their flagship local governance and PFM programs – e.g. the UN-led Local Government and Community Development Program (LGCDP), the ADB-led Strengthening Public Management Program (SPMP) to support the needs at the local level.



Nepal needs to unlock its potential to manage public investments efficiently. Low and poor quality public investments act as an impediment to economic growth. The public investment management inefficiencies are manifested in the public investment process, which does not deliver completed productive assets and infrastructure. Projects on average go on for more than 11 years and some roads and irrigation projects have gone on for more than 30 years. In 2017 the capital budget execution rate was 65.5 which is significantly below the six-year average of 71.6%.

Institutional processes essential for public investment management (PIM) are nearly nonexistent in Nepal. An important aspect of public investment management is the prioritization of projects. A review of capital budget over the past six years indicate that approximately 87% of projects are categorized as ‘priority one’ projects. This leads to inadequate project cycle funding and subsequent delays in project completion. The country currently needs institutional processes for an independent assessment of public investment decisions. There are no clear guidelines on methodologies for screening and appraisal. There is also a lack of monitoring of project implementation. In addition, clear l

A political, historical and legal framework exists in Nepal for citizen engagement. Formal policies and processes have been laid out, whether representational or consultative, at the national and local levels of government. Interim bodies and engagement mechanisms are present at the local levels. In the current political transition, the spirit of citizen engagement and public participation needs to be shepherded in the crafting of laws and regulations replacing the existing ones. Citizens engagement as an enabler for PFM reform has been identified in the PFMRP II of the Government and the engagement has been placed both at policy level and local engagement.

Relationship to CPF

In the Country Partnership Framework (CPF) of 2014-2018, WBG commits to providing support to building the key foundations to strengthen public sector capacity, governance and public expenditure management. Under this cross cutting theme of support, public financial management is explicitly recognized as a means of making sure public expenditure is managed efficiently and effectively. Project design aligns well with the following, highlighted in the CPF as key areas to be addressed during the CPF period: (a) upstream budgeting focused on the development budget; (b) downstream reporting on budget utilization that is transparent, timely and reliable through the use of the treasury single account and upgrading of the Financial Management Information Systems (FMIS); and (iii) introduction of an internal audit function to enhance current budget controls. The CPF recognizes the MDTF for PFM as a tool for support in this area.

C. Proposed Development Objective(s)

Enhance the reliability and execution of the capital budget and strengthen financial reporting for efficient public expenditure management, greater transparency and stronger accountability in the new federal structure.

Key Results (From PCN)

The proposed results to measure the achievement of the PDOs include: (1) improvements in capital budget out-turns in targeted subsectors; and (2) availability of timely and comprehensive annual consolidated financial statements.



The main intermediate results proposed, towards achieving the PDO level indicators are: (a) simplified and effective guidelines for selection of capital projects (b) prioritized project pipeline for selected sub sectors and greater link between their investment budget and forward linked recurrent expenditures;; (c) trained staff on new methodologies for screen and appraising capital projects; (d) coherent PFM procedures and systems for all tiers of Government; (e) timely budget execution reports from SNGs; (f) trained subnational level staff on new reporting requirements; (g) procedures in place for consolidation based on NPSAS and trained staff in place; (h) NPSAS rolled out to all federal level line ministries and financial statements prepared; (i) management information available; (j) ex-ante commitment controls practiced; (k) timely payments; (l) internal audit reports issued using the new framework; (m) holistic training plan developed and implemented; (n) concept for sustainable and structured PFM capacity building endorsed and sustainable training arrangements/capacity in place.

D. Concept Description

The proposed project will support the second phase of Governments PFM reforms as reflected in their reform plan. The project aims to build on the successes of the MDTF funded SPFM I and II and address remaining weaknesses in the PFM landscape with a focus on the basics. The project design will build in flexibility to support emerging areas of PFM in the new federal structure that could result in high fiscal risks if unaddressed. The project design will also factor in the pipeline PFM operations funded by the MDTF, other donor operations as well as the Development Policy Credit that has elements of PFM and build in complementary activities as required.

The proposed project is organized around four complementary components.

Component 1: Public Expenditure Management. This component aims to develop an integrated budgeting systems that factors the capital expenditures and the forward linked recurrent costs; introduce robust public investment management processes and establish systems and controls to improve budget implementation. Under this component, the project will support (a) development, formalization and implementation of robust and simplified guidelines for project selection; (b) strengthen processes and capacity for reliable budgeting focusing on capital expenditure; (c) improve cash management practices to enhance the availability and predictability of funding for the budget and (d) enhance project management capacity and systems.

Component 2 PFM improvements in subnational governments. This component will be designed to take a flexible approach to supporting primarily the central government to implement their evolving institutional mandate to support subnational governments in PFM i.e. to streamline PFM practices, build capacity and safeguard overall public funds in the federal structure. Under this component, activities will be undertaken to: (a) contribute to a cohesive approach (road map) to strengthen Federal / Subnational PFM framework; (b) provide Just-in-time support to meet the evolving needs as required (i.e. capacity building, system requirement studies, preparation of guidelines, special purpose studies/ assessments/policy papers etc.; (c) support the government to engage in Open Government Partnership (OGP) mechanisms for local level governance and (d) Improve and enhance supporting mechanisms for SNGs to enhance their PFM practices for example by supporting the authorities to build in governance indicators in the fund transfer structure/grant formula.

Component 3 Fiscal reporting and controls. This component aims to enhance the quality and availability of fiscal reports for greater transparency, citizen's engagement and decision making; strengthen the overall internal control framework and improve the usefulness of internal audit as a management tool. Activities include: (a) support the



implementation of financial reporting standards aligned with international standards; (b) Improve and implement procedures for consolidating financial information in to a set of comprehensive financial statements (including robust disclosure of information); (c) develop a road map towards establishing an integrated financial management information system (IFMIS), underpinned by a review; (d) support the implementation of this road map to develop an IFMIS aimed at strengthening budgetary controls, cash management, commitment controls, payroll controls, inventory management, timely reporting and reconciliations, reducing discrepancies in expenditure and revenue records, and enhancing the disclosure of fiscal information; (f) train end users on manuals, procedures and systems; (g) improve IT security systems; (h) acquire hardware, including servers, to enhance the primary and secondary data centre operations, disaster recovery, and network connectivity; (i) consolidate the TSA architecture across the tiers of government; (j) introduce reporting tools and support the use of fiscal information by decision makers and the citizens; and (k) establish a control framework and introduce a risk based internal audit methodology.

Component 4 institutionalize capacity building and management of PFM reforms. The proposed activities under this component will establish a structured approach to continuous education and training on PFM for relevant government officials and strengthen the capacity of the PEFA secretariat to coordinate PFM reforms across a broad range of areas. Proposed activities include: (a) develop plans for training in all relevant areas of PFM including IT underpinned by a needs assessment; (b) conceptualize and implement a sustainable institutional solution for structured training on PFM; (c) build institutional capacity to provide and coordinate training efforts, training of trainers, developing training courses, establishing knowledge banks and communities of practice, entering into Memorandums of Understanding (MOUs) with specialized training institutions such as ICAN will be part of this effort; and (d) Strengthen PEFA secretariat with required technical and project management skills, to implement their broader mandate and carry out change management activities.

SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

The project does not involve any construction, civil works or treatment/disposal of old computers. Project activities only includes technical assistance, trainings and capacity building activities. The project will be carried out centrally, in the PMUs and in various government offices.

B. Borrower’s Institutional Capacity for Safeguard Policies

N/A

C. Environmental and Social Safeguards Specialists on the Team

Drona Raj Ghimire, Environmental Safeguards Specialist
Caroline Mary Sage, Social Safeguards Specialist

D. Policies that might apply

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	



Natural Habitats OP/BP 4.04	No
Forests OP/BP 4.36	No
Pest Management OP 4.09	No
Physical Cultural Resources OP/BP 4.11	No
Indigenous Peoples OP/BP 4.10	No
Involuntary Resettlement OP/BP 4.12	No
Safety of Dams OP/BP 4.37	No
Projects on International Waterways OP/BP 7.50	No
Projects in Disputed Areas OP/BP 7.60	No

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

Oct 09, 2017

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

N/A

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APPROVAL

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