



# Combined Project Information Documents / Integrated Safeguards Datasheet (PID/ISDS)

Appraisal Stage | Date Prepared/Updated: 16-Apr-2018 | Report No: PIDISDSA23378



**BASIC INFORMATION**

**A. Basic Project Data**

Country Nepal	Project ID P164783	Project Name Integrated Public Financial Management Reform Project	Parent Project ID (if any)
Region SOUTH ASIA	Estimated Appraisal Date 21-Mar-2018	Estimated Board Date 23-May-2018	Practice Area (Lead) Governance
Financing Instrument Investment Project Financing	Borrower(s) Government of Nepal	Implementing Agency Ministry of Finance	

Proposed Development Objective(s)

Strengthening the effectiveness of PFM institutions, systems and procedures at the federal and subnational levels

Components

- Component 1: Strengthening Public Expenditure and Revenue Management in Federal and Subnational Governments
- Component 2: Strengthening the Office of the Auditor General
- Component 3: Improving Public Procurement
- Component 4: PFM Reform Management and Coordination

Financing (in USD Million)

**SUMMARY**

<b>Total Project Cost</b>	18.00
<b>Total Financing</b>	18.00
<b>Financing Gap</b>	0.00

**DETAILS**

<b>Total Government Contribution</b>	3.00
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Environmental Assessment Category

C - Not Required

Decision

The review did authorize the preparation to continue

## B. Introduction and 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 have grown more slowly, and its relative share in the economy is falling. Similarly, exports continue to struggle while imports are fueled by remittances, which reached 30 percent of GDP. Inflation was in single digit 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 2010/11,<sup>1</sup> 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 that were followed by trade disruptions resulting in the lowest economic growth in 14 years in 2016.

**Economic activity, which rebounded strongly in FY2017 following two challenging years, has once again been disrupted by floods affecting more than one-third of the country.** The rebound in FY2017 stemmed 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 moderated sharply. Government revenue continued to perform well, and spending has also picked up significantly in FY2017 compared to previous years. Nevertheless, ambitious expenditure targets envisioned in the budget have not been met and the quality of spending has not improved with 60 percent of the capital spending occurring in the last quarter. In the first half of FY2018, the spending pressures have increased due to fiscal transfers, election spending, capital goods, and expenditure to implement federalism. Inflation in February 2018 has increased to 5.0 percent (y/y) from 2.7 percent (y/y) in August 2017. Meanwhile, rapid credit growth in early 2017 has slowed, but deposits growth has continued to decline, pushing up the interest rates. On the external side, the cumulative effect of a sharp trade balance deterioration and a slow growth of remittances is putting significant pressure on the current account. Economic activity, which was expected to progress well in FY2018, has been affected by the worst floods in decades, particularly affecting the agriculture output.

**A new government, backed by a historic majority in Parliament, took office on February 15, 2018.** This follows elections for all three tiers (local, state, and federal) of the state architecture defined by the new Constitution, marking a protracted but successful conclusion of a political transition that began with the signing of the Comprehensive Peace Agreement in November 2006. State governments largely mirror the coalition at the center. At the subnational level, funds, functions, and functionaries hitherto managed by the central, district, and village authorities are moving to the 7

<sup>1</sup> Recent data not available



new states and 753 local governments for which new legislation, institutions, and administrative procedures are being formalized as constitutionally prescribed. Meanwhile, central-level authority is being streamlined with a focus on oversight. These exercises at state restructuring are expected to result in improved outreach and service delivery but will likely take time before they become fully operational.

**Public financial management (PFM) is key to the Government of Nepal's strategy for ensuring effective resource allocation, strengthening public service delivery, and creating inclusive and broad-based development.** Aligned with these objectives, in August 2009 the government prepared Phase I of a PFM Reform Program, followed by a Phase 2 PFM Reform Program (FY16/17-25/26) that aims to achieve 8 outcomes.<sup>2</sup> Nepal's PFM reform strategy is supplemented by agency-specific plans such as Office of the Auditor General Nepal (OAGN) Strategic Plan 2016-20 and Nepal Public Procurement Strategic Framework II 2013-16.

**At policy level, Nepal is undergoing an overhaul of the PFM legal framework in support of its new federal structure.** The first approved World Bank-funded programmatic fiscal and PFM development policy credit (DPC) incentivizes the government on passage of key PFM laws. These laws define the entire PFM architecture in the new federal structure. The DPC also advocates for other upstream and downstream improvements for well-functioning PFM. Timely and predictable budget releases, enhanced budget realism, increased transparency in government spending, reduction in audit irregularities, and availability of information on tax collection are a few such expected improvements under the DPC operation.

**Nepal has taken significant strides reforming its downstream PFM processes and system.** These were undertaken with the objective of ensuring a transparent, efficient, economical, and accountable use of public resources. As part of its reform effort, the Government of Nepal in 2009 established a PEFA Steering Committee as an apex body and set up a PEFA Secretariat; and in both 2008 and 2015 carried out PEFA assessments.

**The PFM agenda has also been a top priority for development partners to promote efficient and effective public service delivery.** A World Bank-administered Multi-Donor Trust Fund (MDTF) was established in 2010.<sup>3</sup> The PFM MDTF has been assisting government to modernize Nepal's PFM systems through both supply-side and demand-side projects: (a) supply side includes modernizing payments through a Treasury Single Account (TSA), availability of real-time fiscal information on the Financial Comptroller General Office (FCGO) website, revenue management by means of a Revenue Management Information System (RMIS), and upgrading audit systems through intervention with OAGN; and (b) demand side includes strengthening civil society engagement with government's supply-side services on PFM accountability.

**Underscored by PFMRP II, MDTF focuses on 3 priority outcomes.** These outcomes are (a) strengthened efficiency and results orientation of the budget cycle at federal and subnational levels, evidenced by improvement in the capital budget execution rate and tax collection and supported by improved tax administration processes and efficient PFM-related IT systems; (b) increased professional capacity of key PFM stakeholders, improving capacity-building institutions, and enhancing capacity of the PEFA Secretariat to design, manage, and coordinate PFM reform; and (c) enhanced PFM accountability by means of a strengthened external audit function, increased transparency and citizen

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<sup>2</sup> Outcome 1: Improved Budget Credibility; Outcome 2: Improved comprehensiveness and transparency of the budget; Outcome 3: Improved policy-based budgeting; Outcome 4: Predictability and control in budget execution; Outcome 5: Improved accounting, recording, and reporting; Outcome 6: External scrutiny and audit; Outcome 7: Improved human resource management for PFM; Outcome 8: Improved donor practices.

<sup>3</sup> Currently there are 6 MDTF donors: European Union (EU), UK Department for International Development (DFID), Government of the Swiss Confederation, Government of Norway, Australian Government Department of Foreign Affairs and Trade (DFAT), and United States Agency for International Development (USAID).



participation in the budget process, and increased involvement of relevant Parliamentary committees and oversight bodies. Proposed project activities closely align with these priority areas.

**Despite the many initiatives, there is continued need to consolidate federal-level PFM reforms.** The latest Public Expenditure and Financial Accountability (PEFA) assessment notes that the credibility of the budget is a concern with significant variance of expenditure composition. Without a government mandate, consolidated financial statements are not prepared on basis of Nepal public sector accounting standards (NPSAS). The government provides substantial funding to public sector enterprises through its budgetary system by way of capital investments, loans, and grants. Due to inadequate reporting, monitoring fiscal risks arising from state-owned enterprises is a challenge. Internal control and internal audit are key areas of concern and confirmed by annual OAGN reports. The PEFA also notes that there are issues in accounting for tax assessments and collections: tax arrears continue to mount each year, and insufficient attention is paid to clearing old arrears. Many stand-alone IT systems have no integration to each other for recording core FM transactions.

**The OAGN recognizes a need to address three key challenges in public audit function.** These are (a) deepening knowledge and coverage of new ISSAI-compliant methodology, (b) strengthening quality assurance and audit follow-up function, and (c) providing new local-level audit requirements. The Supreme Audit Institution's (SAI) Performance Monitoring Framework (PMF) 2014 notes that specific interventions must address these challenges.

**There are numerous challenges facing public procurement in Nepal.** Accounting for 75.86 percent of total capital expenditures, the largest capital spending sectors are roads, irrigation, urban development, defense, and health.<sup>4</sup> Public procurement environment suffers from low capacity in the Public Procurement Monitoring Office (PPMO) and most procuring entities and in the private sector. This is compounded by weak compliance with the legal and regulatory framework and weak enforcement as well as weak capacity at subnational government (SNG) level. Procurement performance continues to be affected by process variances due to lack of standardized documents, guidelines, and technical notes. Programs and measures for strengthening procurement have not been implemented in an organized and sustained manner largely due to the inadequacy of required resources. There is disconnect with procurement, planning, and budgeting to ensure adequate resources will be allocated.

**There are few female staff who work on PFM related technical areas.** The current staff are mostly concentrated in lower administrative or officer levels at the federal level. Female staff need capacity enhancement to be able to fully engage and contribute in PFM processes at intergovernmental or subnational levels.

**The new federal structure presents opportunities and challenges to develop an engagement that is anchored in the shift underway in the country's political history.** Strategic fit of the proposed Integrated PFM Reform Project lies primarily in providing essential technical assistance to implement the new policy framework. In doing this, the project will consolidate and build on the foundations created at the federal level by the continuous PFM reforms and establish building blocks for a coherent and integrated PFM framework in federal- and subnational-level arrangements. Projects will have a strong downstream focus while also focusing on strengthening essential upstream processes. There are no established PFM processes yet for intergovernmental or subnational-level PFM activities. This lack of systems, processes, and capacity at the subnational level is likely to pose an immediate risk to use and management of resources. As a transitional measure, District Treasury Comptroller Offices (DTCOs) will have an interim acting role until the provincial treasuries are established. Development partners continue to restructure their flagship local governance

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<sup>4</sup> Annual Report of the Auditor General, 2015



and PFM programs to support subnational needs. These interventions however require guidance by an overall PFM framework for greater coherence and efficiencies.

### **C. Proposed Development Objective(s)**

Development Objective(s) (From PAD)

Strengthening the effectiveness of PFM institutions, systems and procedures at the federal and subnational levels

#### Key Results

The key results of the IPFMRP are based around the strategic objectives of the Governments PFMRP. These are as follows:

- Improved aggregate capital budget out-turns at the federal level;
- Comprehensive accounting and reporting procedures in place in Federal and SNGs;
- Improved audit planning and quality management for audit of federal and sub-national entities;
- Improved timeliness of contract award in selected key sector agencies at federal level and selected SNG.

### **D. Project Description**

**The proposed project will support high priority activities of the second phase of Government's PFM reforms as reflected in the PFMRP (2016/17-2025/26).** The proposed project will also support the OAGN Strategic Plan 2016-2020. The project design is anchored on the principles of: (1) basics first, focusing on core reforms to build a strong foundation and address fundamental weaknesses in the core PFM architecture; (2) incrementalism, whereby the design will build on the successes of the MDTF funded SPFM I and II in a logical sequence; (3) flexibility in resource allocation to support emerging areas of PFM in the new federal structure that could result in high fiscal risks, if unaddressed; and (4) functional and behavioral improvements in PFM areas of continuous reforms. The design of the proposed project supports the building blocks that are essential to achieve the triggers of DPC. The technical assistance will contribute directly or indirectly towards the achievement of these triggers.

**The proposed project is organized around four complementary components:** (1) Public Expenditure and Revenue Management in Federal and Subnational Governments; (2) Strengthening the office of the Auditor General; (3) Public Procurement Improvement; and (4) PFM reform management and coordination. There are a multitude of interlinked actions across these components.

**Component 1: Strengthening Public Expenditure and Revenue Management in Federal and SNGs (US\$7 million).** Component 1 contributes to the PDO by (a) establishing coherent and improved PFM procedures for planning, budgeting, reporting, internal control, and internal audit across all tiers of governments; and (b) establishing sustainable PFM training arrangements. This component will have 3 subcomponents: enhancing budgeting and revenue management, strengthening fiscal reporting and controls, and strengthening PFM training capacity.



**Component 2: Strengthening the Office of the Auditor General Nepal (US\$4 million).** Component 2 aims to address the strategic objectives of OAGN as articulated in their comprehensive strategic plan and OAGN Workplan. Project objectives will be met by (a) deepening the knowledge and coverage of the new ISSAI-compliant methodology, (b) strengthening quality assurance and audit follow-up function, and (c) catering to the new audit requirements of the SNGs. Accordingly, Component 2 will support three sub-components: enhance audit quality and reliability in federal and SNG audits; enhance the sustainability and use of IT tools for audit management, and strengthen citizen participatory performance audits.

**Component 3: Improving Public Procurement (US\$4 million).** Component 3 supports the PDO by improving public procurement performance progressively in 5 Key Sector Agencies (KSA)<sup>5</sup>. There will be three subcomponents: (a) public procurement governance and oversight, (b) procurement capacity development and professionalization, and (c) performance monitoring with electronic government procurement (e-GP) platform. The Public Procurement Monitoring Office (PPMO) will have overall responsibility for implementation and coordinate with the 5 KSAs and SNGs. Support to this component will be in the form of procurement consultancies; refurbishment of PPMO; capacity development including twinning arrangements; and exposure visits.

## **E. Implementation**

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<sup>5</sup> Department of Roads (DOR), Department of Local Infrastructure Development and Agricultural Roads (DOLIDAR), Department of Irrigation (DOI), Department of Health Services (DOHS), and Department of Water Supply and Sewerage (DWSS) or their future restructured corresponding organizations and selected subnational governments.



Institutional and Implementation Arrangements

**The institutional and implementation arrangements consist of 3 main layers:** (1) PEFA steering committee at strategic level; (2) PEFA Secretariat at the coordination level and (4) implementing agencies and their project teams at operational level.

**Ministry of Finance (MoF) will be the primary executing agency for the project.** PEFA steering committee chaired by the Finance Secretary and senior level representatives from various core PFM agencies/ministries, including OAGN and PPMO, provides strategic direction to project implementation ensuring achievement of project development objectives. The steering committee, which was established in 2008, has been active in guiding SPFM I and II activities.

**The PEFA Secretariat will coordinate and facilitate the implementation of the different components of the proposed project.** PEFA secretariat has been in operation since 2009 to coordinate SPFM I and II activities. The project will benefit from the experienced staff of the Secretariat to coordinate project functions. PEFA secretariat will continue to have a Coordinator, Member Secretary and a project team to coordinate project activities and implement a few selected activities. Project teams are formed or project focal person appointed in implementing agencies for closer attention on project activities.

**Implementation of project activities will rest with ministries, departments and agencies of Government, aligned with their institutional mandates.** These Implementing agencies (IAs) will be responsible for preparation of their procurement plans, annual work plans as well as for the financial management and procurement of their respective activities. Distribution of implementation responsibilities across the four components are shown in table 1 below. The PEFA Secretariat will consolidate annual work plans and procurement plans from implementing agencies for transmission to the World Bank.

<i>Component</i>	<i>Responsible implementing agencies</i>
Component 1: Public Expenditure and Revenue Management in Federal and Subnational Governments	<ul style="list-style-type: none"> <li>• PEFA Secretariat</li> <li>• National Planning Commission</li> <li>• PAC</li> <li>• MoF FCGO</li> <li>• MoF Budget Division</li> <li>• MoF Revenue Division</li> </ul> <p>(SNGs and ICAN/<sup>e</sup> will benefit from capacity building but will not be considered as responsible implementing agencies from a project management perspective. Ministry of Federal Affairs and General Administration/<sup>f</sup> will provide a supporting role to coordinate with SNGs and will also not be considered an implementing agency)</p>
Component 2: Strengthening the OAGN	<ul style="list-style-type: none"> <li>• Office of the Auditor General Nepal</li> </ul>
Component 3: Public Procurement Improvement	<ul style="list-style-type: none"> <li>• Public Procurement Monitoring Office</li> </ul> <p>(KSA and SNGs will benefit from project activities but will not be considered as implementing agencies)</p>
Component 4: PFM reform management and coordination	<ul style="list-style-type: none"> <li>• PEFA Secretariat in partnership with Ministry of Federal Affairs and General Administration for SNG support</li> </ul>



**F. 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 IT equipment and primarily includes trainings and capacity building activities. The project implementing agencies are located centrally in various government offices.

**G. Environmental and Social Safeguards Specialists on the Team**

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

**SAFEGUARD 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	



## KEY SAFEGUARD POLICY ISSUES AND THEIR MANAGEMENT

### A. Summary of Key Safeguard Issues

1. Describe any safeguard issues and impacts associated with the proposed project. Identify and describe any potential large scale, significant and/or irreversible impacts:

N/A

2. Describe any potential indirect and/or long term impacts due to anticipated future activities in the project area:

N/A

3. Describe any project alternatives (if relevant) considered to help avoid or minimize adverse impacts.

N/A

4. Describe measures taken by the borrower to address safeguard policy issues. Provide an assessment of borrower capacity to plan and implement the measures described.

N/A

5. Identify the key stakeholders and describe the mechanisms for consultation and disclosure on safeguard policies, with an emphasis on potentially affected people.

N/A

### B. Disclosure Requirements

### C. Compliance Monitoring Indicators at the Corporate Level (to be filled in when the ISDS is finalized by the project decision meeting)

#### The World Bank Policy on Disclosure of Information

Have relevant safeguard policies documents been sent to the World Bank for disclosure?

Yes

Have relevant documents been disclosed in-country in a public place in a form and language that are understandable and accessible to project-affected groups and local NGOs?

Yes



### All Safeguard Policies

Have satisfactory calendar, budget and clear institutional responsibilities been prepared for the implementation of measures related to safeguard policies?

NA

Have costs related to safeguard policy measures been included in the project cost?

NA

Does the Monitoring and Evaluation system of the project include the monitoring of safeguard impacts and measures related to safeguard policies?

NA

Have satisfactory implementation arrangements been agreed with the borrower and the same been adequately reflected in the project legal documents?

NA

### CONTACT POINT

#### World Bank

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Sr Financial Management Specialist

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Lead Procurement Specialist

#### Borrower/Client/Recipient

Government of Nepal

#### Implementing Agencies

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**APPROVAL**

Task Team Leader(s):	Jiwanka B. Wickramasinghe Akmal Minallah Zafrul Islam
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**Approved By**

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Country Director:	Bigyan B. Pradhan	17-Apr-2018