

Appendix V

The Main Findings of Two Key Fiduciary Assessments: The Country Financial Accountability Assessment (CFAA) and the Country Procurement Assessment Report (CPAR)

A. The Country Financial Accountability Assessment¹

Context

Nepal's legal and regulatory framework for ensuring public sector financial accountability is impressive for a country at its level of economic development. The 1990 Constitution requires the Ministry of Finance to submit a detailed comparison of the financial results and budgets of all ministries to Parliament at the end of each fiscal year. The Constitution also accords the Auditor General (AG) complete legal and professional independence, exempting his emoluments and the budget of the Office of the Auditor General (OAG) from parliamentary vote. The Constitution also created a Commission for the Investigation of Abuse of Authority (CIAA) to investigate and recommend actions against errant and corrupt officials and prosecute them, if necessary.

Furthermore, when the Public Accounts Committee (PAC)—headed by a member of the main opposition party in Parliament—was in session, it was proactive in its undertakings. It is schedule to meet year round discussing public accounts and the AG's annual report and recommendations, as well as all aspects of public sector financial management. All meetings are open to, and receive full coverage in, the press, and it intervenes in on-going procurement processes when impropriety is suspected. Its collaboration with the AG is exemplary. It sends the AG's recommendations to the HMGN with a directive for the implementation of such recommendations.

The 1999 Financial Procedures Act and 1999 Financial Administration Regulations (FAR) contain detailed and comprehensive provisions for: (i) budget preparation and approval; (ii) accounting and reporting on budget implementation every four months; (iii) a detailed report (Schedule 2 of the FAR) that includes a statement, not only of expenditures, but also of physical results and goals achieved; (iv) elaborate procurement and internal control procedures; (v) annual financial statements at all levels, with a consolidated financial statement for the whole public sector at the end of each fiscal year; (vi) internal and external audits; (vii) ministerial review of project implementation at regular intervals throughout the year, with rewards for good performers and explanations for poor performance.

The 1999 Local Self-Governance Act (LSGA) presents the structure of local government. The roles, responsibilities and relationships of District Development Committees (DDCs), Municipalities, and Village Development Committees (VDCs), and the Councils which govern them are explained in the LSGA. The regulations for financial accountability at the local level are even more impressive than those at the center. They contain provisions and instructions for: (i) budget preparation; (ii) proper accounting

¹ The CFAA was jointly carried out by HMGN and the Bank beginning in December 2001, with the establishment of a high level National Steering Committee (NSC). The NSC played a pivotal and strong leadership role which demonstrated the high level of HMGN ownership, and also was extremely useful in guaranteeing a high quality product. Throughout the process, a number of stakeholders meetings were held, including with representatives of donors, government agencies, oversight agencies and private sector agencies. Following a stakeholder's workshop in which over 200 people participated, formal discussions of the final CFAA report were carried out in June 2002. Subsequently, HMGN adopted the Development Action Plan of the CFAA.

and reporting; (iii) creation of an Accounts Committee in every local body to oversee financial management; (iv) internal and external audits; (v) project monitoring; and (vi) an elaborate system for “ex-post” evaluation of projects which assesses, not only the direct costs and benefits of each project, but also the impact on employment creation and on the environment.

Key Findings

The following are the CFAA’s key findings.

While the legal framework appears comprehensive, Nepal has been less successful with compliance and implementation of the regulations, but commitment to upgrade the public sector’s financial management is strong. Compliance with the provisions of the FAR either has not been accorded the priority implied by the regulations. Schedule 2 of the FAR which requires reporting on physical and goal achievements is inadequately monitored. With adequate monitoring, the linkages between financial progress and physical outputs/outcomes could be measured in ways that would fully meet the Bank’s financial management requirements for Bank-financed projects. The imposition of penalties and fines prescribed by the FAR for non-compliance with reporting or other requirements is not strictly enforced. Until recently, 95% of the legal cases brought by the CIAA against errant officials have been unsuccessful but the success rate is reported to have improved to as much as 50%.

At the local level, monitoring has been weak with the lack of adherence to M&E by most institutions as required by the LSGA. While accounting staff possess minimum technical qualifications required for the job, they have little or no experience in project accounting and financial management. Technical staff are known to give low priority to resource allocation and to establishing good financial management systems in their respective agencies/projects. Compliance with internal controls and internal audits have to be strengthened. While the proactive involvement of the PAC during project implementation process has helped to check any malpractices or misdeeds, it can at times cause delays in decision-making with negative implications for development.

Several explanations have been given for the dichotomy between precept and practice: (i) insufficient political commitment or demand for compliance with financial accountability rules and regulations; (ii) reluctance to punish or impose sanctions on anyone; (iii) reported corruption in civil service appointments, promotions and transfers; (iv) politicization of the civil service and its decision-making processes; and (v) some donors and foreign development partners bypassing the requirement for establishing financial systems and requirements for the projects they support, thereby contributing to the lack of compliance with the country’s laws and regulations.

Ultimately, the problem with compliance can be attributed to two basic factors. First, Nepal is still in the process of fully developing a solid financial management framework for implementing the laws and regulations on public accountability. For example, tying expenditures to outputs and outcomes requires a budgetary system that specifies outputs or results expected from expenditures as well as funds; accounting and reporting systems that record/report quantitative and qualitative achievements in addition to financial data/financial statements; and an auditing system which enables an independent auditor to trace expenditures and their results. Second, political instability including frequent government changes and more urgent priorities have diminished the attention on financial management needs.

The present challenge for Nepal is supporting institutional changes to shift away from inadequate compliance to earnest and consistent implementation of the country’s existing impressive legal and regulatory framework. The CFAA’s Development Action Plan (DAP) contains a host of recommendations towards improving financial accountability of the public sector and a summary is provided below.

Budgeting and Accounting

Transparent criteria must be developed for selecting officials to handle state funds, whether in the form of revenue or as spending budget. A key requirement would be the ability of the individual to properly account for the funds as stipulated by existing regulations, including reports on physical results or measurable goals achieved from previous expenditures and to be achieved from the proposed program/development expenditure.

No budget should be accepted or approved for any public office, whether at the village, municipal, district, department or ministry level, nor should Parliament approve the national budget unless the relevant budget contains: (i) a retrospective account of physical or other measurable achievements or goals resulting from previous expenditures; and (ii) a prospective forecast of the physical results or other measurable goals expected from proposed expenditures. A suitable simplified framework should be developed that can be realistically implemented at the local (village, municipal and district) level.

Each disbursement to any office (whether at local or at central level) should be made against a report from that office showing: (i) expenditures for the immediately preceding period and their physical or other measurable achievements; and (ii) the proposed expenditures and their anticipated physical or other measurable achievements.

Independent Auditing and Parliamentary Oversight

The following measures would go a long way to improving the chances that the recommendations of the OAG and the PAC are implemented.

- ⚡ The Monitoring Section of the National Planning Commission (NPC) should be strengthened to ensure full ownership by NPC for instituting a realistic system of monitoring all development projects, in addition to the core projects, in close collaboration with concerned line ministries, and to report their progress three times a year.
- ⚡ The Financial Comptroller General Office (FCGO) and the internal audit services at central and local levels ought to be strengthened to be able to: (i) certify offices qualified to receive and properly account for funds; (ii) monitor compliance with the new regulations (that is, the above recommendations) all through the year; and (iii) take proactive actions to rectify any violations of rules and regulations before they are raised by external auditors.
- ⚡ The OAG should improve its capacity to confirm annually whether or not the new rules are being complied with and to provide services in financial auditing and outcomes-based performance auditing.
- ⚡ Capacities of the line ministries have to be built to effectively monitor their programs and prepare time-bound action plans to rectify issues or implement recommendations in the OAG's report. MOF must monitor the implementation of the action plans of all ministries.
- ⚡ MOF should establish an effective monitoring system to follow up on reported irregularities and periodically report on the actions taken. Such monitoring should include the status of the following: (i) audit backlogs and action plan to keep all audits up-to-date; (ii) revenue realization; (iii) clearing reimbursable grants and loans; (iv) tax deduction at source; (v) repayment of principal and interest made by HMGN on guaranteed loans but not recovered from concerned institutions; (vi) dividends receivable, and other receivables, from corporate bodies and boards; (vii) amounts to be paid by HMGN to various entities; and (viii) follow-up on the recommendations of the PAC.

€# The PAC must be given an unambiguous and enforceable mandate to insist on political demand for accountability and transparency and compliance with the new regulations.

Fiduciary Risk and Programmatic Lending

For fiduciary risk on programmatic lending to approximate the fiduciary risk now accepted for project lending, accountability and internal control standards in the whole civil service must approximate those currently existing in Bank-financed projects. The existing legal/regulatory framework meets these standards but compliance must be enhanced. The objective for HMGN should be to harmonize the reporting system that is acceptable to all donors. There is no reason to not consider some budgetary support/programmatic lending, but it should be accompanied by: (i) a pragmatic program of targeted assessment and strengthening of sectors and institutions scheduled to benefit from such lending; and (ii) implementation of the recommendations made in the DAP for the public sector over the medium term.

Sectors, ministries and institutions envisaged for budgetary support should be the first to be assessed and certified by a panel of independent experts representing the accountability institutions which include MOF, FCGO, NPC and OAG (or may also include experts designated by donor partners participating in budgetary support) as complying with the accountability standards recommended above.

Following the full implementation of the proposed integrated financial management improvement program, a quick review would be desirable to confirm the effectiveness of the compliance system, before generalized programmatic lending benefiting all sectors, ministries, and institutions is launched. All levels of government would need to be reviewed for adequate compliance before moving forward.

A Task Force or a Reform Monitoring Committee should continue to monitor the implementation of the recommendations of the CFAA. Implementation status should be periodically reported to the Finance Committee of the Parliament, the Finance Secretary, and Nepal's development partners.

Capacity Building and Implementation of CFAA Recommendations

Implementation of the CFAA recommendations in the form of the DAP by the entire public sector has been underway since mid-2002. A progress report of the Plan is regularly updated and posted on the MOF's external website. In addition, the Government requested the Bank's assistance in two areas: capacity building of the accounting and auditing staff and upgrading the quality of audits. Specifically, the request entailed enhancing the capacity of the OAG towards improving public sector financial accountability. In March 2003, the Bank provided an Institutional Development Fund (IDF) grant of US\$0.5 million. On the basis of the CFAA recommendations and agreement reached with the OAG, the grant will finance: (i) the revision of the audit guidelines and reporting methodology to be compatible with international standards or best practice; and (ii) the establishment of institutionalized training arrangements within OAG to implement the guidelines.

B. The Country Procurement Assessment Report²

Context

Like most countries, Nepal's constitution does not address the issue of public procurement, but in contrast to most countries, there is no law (in the sense of a generally applicable set of rules enacted by the legislature) about public procurement. In this respect, Nepal (like its neighboring countries Pakistan and India, and a few others) is different from most other countries in the world. Most countries have introduced a public procurement law, enacted by parliament which alone can change it, which law deals exclusively with the public procurement of goods, works and services by governmental entities at all levels, and most often both for the central authorities as well as those on a provincial and communal level.

The system used in Nepal is represented by the Financial Administration (Related) Rules of 1999" (FAR99) was originally introduced by the British but is no longer practiced in the U.K. This approach consists of the issuance by government (rather than by the legislature) of a set of financial rules which essentially describe the financial powers of various governmental authorities, and in particular the procedures they should follow in securing and disbursing the public funds required to discharge their functions, including the rules governing the procurement of public contracts. Having been issued by government, these rules—i.e., FAR99—can also be changed by government, without any approval by the legislature, which it is felt in most countries is not in the public interest. Rules of this nature, which govern the use of huge amounts of public funds, should be difficult rather than easy to change, and they should be changed only in a public and transparent manner.

Key Findings

Procedures and Practices

FAR99 represents an improvement over its predecessor but the enactment of a Public Procurement Law is a necessity. The Bank revised the rules for National Competitive Bidding (NCB) under Bank-financed contracts, in order to properly reflect the interests of the public purchaser. In fact, the list (noted below) indicates the areas of the public procurement system requiring attention.

- ⚡ Provision of sufficient time for bid preparation.
- ⚡ Bidders access to bidding documents by mail or in person.
- ⚡ Evaluation of bids according to pre-disclosed criteria.
- ⚡ Bid opening in only one place and immediately after deadline for bid submission.
- ⚡ No preference to local bidders competing with foreign bidders.
- ⚡ Contract awarded to lowest evaluated bidder.
- ⚡ No post-bidding negotiations with the lowest or any other bidder.
- ⚡ No bid rejection on the basis merely of price estimates.
- ⚡ No rebidding without IDA's prior concurrence.
- ⚡ Requirement for all bidders to provide bid and performance securities.

² The CPAR was carried out as jointly between the Bank and HMG. The work was initiated in November 1999 and finalized in April 2002.

- ⊘ No awards by lottery.
- ⊘ Extension of bid validity only according to Bank's International Competitive Bidding (ICB) rules.
- ⊘ No bidding on the basis of a percentage premium over estimated cost.

Bidding Documents

The following includes further recommendations to strengthen the National Competitive Bidding (NCB) provisions in the procurement schedules of credit agreements.

- ⊘ Bidders must be allowed, prior to the deadline for bid submission, to amend or withdraw their bids.
- ⊘ Larger civil works contractors must not be prohibited from competing against smaller contractors; a two-envelope system must not be used for the procurement of goods and works.

Issues Related to Expertise, Audit, Anti-corruption

In addition to the problems related to the legal and procedural framework in which procurement is conducted in Nepal, there are other problems mentioned below:

- ⊘ Like in almost all borrowing countries of the Bank, there is a tremendous need to train public officials in the principles and practices of public procurement.
- ⊘ The Auditor General's staff has been found, in the case of donor-financed contracts, to insist upon the application of local procurement rules instead of the donor's procurement rules (although the applicable Nepalese rules make it clear that the latter should apply).
- ⊘ Nepalese laws and rules dealing with corruption seem to penalize only passive corruption (i.e., the soliciting or accepting of bribes by public officials), but not acts (just as dangerous) of active corruption (i.e., the offering or giving of bribes to public officials by private parties).
- ⊘ There is a perception amongst the bidders and business community that corruption is a problem in public procurement in Nepal.

Summary of Major Recommendations

The 2002 CPAR contains the following principal recommendations:

- ⊘ Enacting a modern, transparent and competitive public procurement law, based on the UNCITRAL Model Law for Procurement, to apply to public procurement by all public entities in Nepal at all levels, as well as to parastatals.
- ⊘ Creating a small, independent procurement agency, with functions defined by the Public Procurement Law (essentially policy, and not oversight or line clearances of procurement decisions).
- ⊘ Pending the enactment of such a Public Procurement Law, amend FAR'99 in the sense of changing the anti-competitive rules and practices listed in this Executive Summary.

Review and develop as needed standard bidding documents to be used for procurement financed by HM own government.

Develop and accelerate procurement training at all levels of government, including the Auditor General's staff.

- €# Instructing the Auditor General's staff, in the case of donor-financed procurement, to insist on the application of the donor's procurement rules and not of local procurement rules.
- €# Amending the anti-corruption legislation in such a way as to (i) impose harsh penalties (including blacklisting) on the acts of active fraud and corruption, particularly the offering/giving of bribes to public officials, and (ii) specifically allowing/inviting bidders to report acts of corruption by other bidders, as well as solicitation of bribes by public officials.

Capacity Building and Implementation of CPAR Recommendations

The Government is strongly committed to implementing the CPAR recommendations. The Government revised provisions of the FAR99 soon after the publication of the CPAR. They include ensuring sufficient time for bid preparation, evaluation of bids according to pre-disclosed criteria, awarding of bids and prohibiting post-bidding negotiations with bidders.

The Bank is currently providing technical assistance through a three-year IDF grant of about US\$0.3 million to implement three areas of the above-mentioned CPAR recommendations. The grant—launched in March 2003—will finance: (i) the development of a draft modern transparent and competitive Public Procurement Law in line with international standards and related rules and procedures; (ii) the creation of a comprehensive framework for public procurement training and building a pilot training program particularly for trainers and officials responsible for the management of public procurement.