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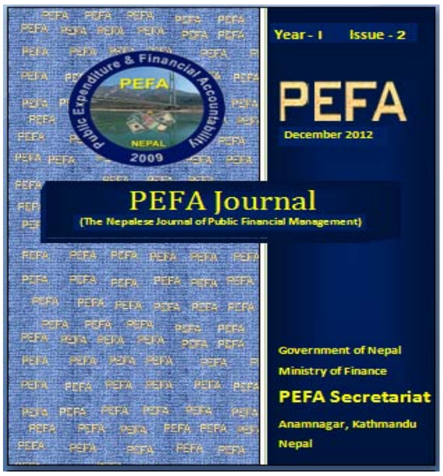
PEFA Secretariat

Anamnagar, Kathmandu, Nepal

Phone: 014770706 Fax: 014770387

E-mail: pefanepal@pefa.gov.np

Web Address: http://www.pefa.gov.np



EDITORIAL

Public Expenditure and Financial Accountability (PEFA) Secretariat is proud to announce the publication of the third volume of the PEFA Journal. As it contains articles of Public Financial Management (PFM), it has been considered as a pioneer Journal of this kind in Nepal.

Articles, the ones related to Public Financial Management, have been published often in the past. And we have continued the very process for now and in upcoming ones as well. Thus, taking the earlier points into account; some of the articles, with the topic Nepal's Experience in Trade Based Money Laundering, Realistic Budget for Capital Expenditure, Nepal Public Sector Accounting Standard, Local level Public Financial Management Reform Initiatives etc. are included in this issue.

Focusing upon the upcoming second PEFA Assessment next year, it's been so planned to present our next issue on the specially focusing on the theme. We expect and welcome the articles that are research-based and address as public prominent financial management issues that the country is facing in various contexts. We hope you would like this issue and look forward to receiving your constructive feedback so that we in the future would be able to enhance the quality of the Journal.

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How do budget reforms link to development outcomes? A Nepalese Experience

Bhanu Prasad Acharya[1]

Politics in Transition

Nepal is passing through a difficult process of transition awaiting political, social and economic transformation. Political instability emanating from delayed process of post-conflict management and constitution building has not only undermined the economic development process but also stalled the governance reform including, of course, public financial management (PFM) reform.

Nepal made significant strides in budgetary process and enhanced public accountability of the resource usage after the restoration of democracy in 1990. A very long period before that was a period with very poor public accountability system that protected feudal class and ruling elites from all sorts of errands. Public procurements were fraught with corruption, but much less were reported in public. There was no mechanism for public scrutiny of public financial management. Statutory body for auditing of public accounts existed but the reports were severely delayed by over 21 months after the end of fiscal year making them absolutely irrelevant for any control of malfeasance and corruption.

After the democratic change of 1990 several new policy measures in resource planning, budgeting, procurement, accounting, reporting and public accountability were introduced with success, but before proper institutional development could take place, the country faced a serious insurgency. Since 1994 due to frequent change of government where a government lasted no more than two years on the average, the capacity of the central government to create new institutions and reform the existing ones was constrained. At the local level, since year 2000 there has been no election of the office-bearers. This has severely weakened the public financial management and public accountability mechanism at the local level.

[1] Mr. Bhanu Prasad Acharya is the Auditor General of Nepal. This article is a revised version of the paper presented in ODI, CAPE conference on "Budget in the real world" held in London during 13-14 November 2013.

In the past seven years, because of post-conflict transition and political instability, almost all of the accountability promoting institutions at the apex level remained without their Chief Commissioners or CEOs.

The post conflict transition is awaiting political stability with the expectation that the second Constituent Assembly that has come after the election on November 19, 2013, will find amicable ways to resolving the pending issues and then the country will take a stable course and move forward at a faster pace.

Economic Context

The economic reform agenda introduced in 1990s brought some remarkable improvements at the beginning in terms of enhanced and diversified private sector investments, infrastructure creation, employment generation, increased output that contributed significantly not only to economic growth but also substantial poverty reduction and improvement in human development indicators.

A historic rate of over 7 % economic growth achieved in 1994 was never realized again. The pace of reforms slowed down after 1995 mainly because of political instability and insurgency. Changing governments led by parties with different ideological thoughts, inadequate institutions, low morale of bureaucracy, less attention in social aspects and capacity constraints brought problems in continuing reform initiatives.

In spite of political instability over-shadowing the economic issues an average moderate rate of 4.2 percent GDP growth achieved over the last five years is considered as below expectation. The economic issues always remained in the slogan of the political parties but rarely prioritized in implementation. Similarly, the weak infrastructure, troubled industrial relations, rising unemployment and high inflation contributed to a lower rate of economic growth. The sectoral composition of GDP shows that almost 50 percent of it comes from services sector, 36 percent by agriculture and less than 6 percent from industries. The contribution of agriculture and industry in GDP is declining and the share of services is increasing. The contribution of remittance to GDP has gone up to 23 percent covering 56 percent of households in just 10 years since 2002. Total revenue of the government has greatly improved and is now close to 17 percent of GDP, public debt has substantially declined to 30 percent of GDP which is well below the average of least-developed countries. The risk of debt distress is low giving fiscal space that can be used in financing large infrastructure projects and enhancing social safety net programs, if other factors including politics are in order. The increasing contingent liabilities created through state owned enterprises, pension and social security liabilities and increasing recurrent expenditure and decreasing capital expenditure are of a serious concern.

Institutions accountable for PFM

The main central finance institutions involved in PFM are Ministry of finance (MOF), National Planning commission (NPC), Financial Comptroller General Office (FCGO) and Public Procurement Monitoring Office (PPMO). Similarly, the oversight agencies involved in PFM functions include the Office of the Auditor General (OAG), the Commission for the Investigation of Abuse of Authority (CIAA) and National Vigilance Centre (NVC). However, Nepal instituted a very strong Public Accounts Committee of the Parliament after 1990 constitution. These institutions play key role in accountability, governance and scrutiny. The role of sectoral ministries also cannot be undermined.

The MOF is responsible for economic and fiscal policy matters, budget management, and foreign aid and revenue affairs. The MOF is largely concentrated on fiscal policy formulation and less involved in monitoring and budget execution. The NPC is an advisory body involved in planning and development, capital expenditure allocation and economic and development policy affairs. The Nepal Rastra Bank (NRB) i.e. the Central Bank is mainly responsible for monetary and financial matters. The FCGO carries core expenditure function including treasury management, internal control, accounting and debt management.

Public Procurement

Public Procurement in Nepal faces the challenges of fairness in competitive bidding, lack of trained staffs in PPMO and low compliance with procurement law including effective appeal process. Simplified procedures, strengthening the procurement unit, contract management and institutionalization of e- procurement are the areas that need attention. Contract and procurement management is weak resulting to substandard work, cost and time overrun and leakage. Various reforms and good practices introduced in public procurement have yet to give result.

Role of SAI in PFM reforms in Nepal

Office of the Auditor General of Nepal (OAG/N) as a Supreme Audit Institution of Nepal has been contributing to promote transparency and accountability in the financial management of the country. The changes in the audit methodology and procedures to adopt the risk based audit approach in the financial audit are the major shift in the public audit. Similarly, focus on performance audit; though in a limited scale, covering policies related to revenue, social services, infrastructure and public finance sustainability has contributed to policy reforms. Similarly, Civil Society Organizations' participation has been initiated in the process of performance auditing to enhance accountability. The OAG/N has been raising observations on revenue leakage and under assessment of the value added tax and income tax. During the implementation of the audit report the tax authorities are recovering additional revenue annually from the tax payer. Under the performance audit the effectiveness of internal control has been evaluated and the internal control checklist developed which is based on Committee of Sponsoring Organizations framework.

The reporting format has been changed to make it reader friendly and financial audit manual has been developed and implemented to make the financial audit in compliance with ISSAI. The annual report of the OAG/Nepal has been submitted within the 9 month of the end of fiscal year. Thus, as an oversight agency OAG is playing important role to enhance the financial governance, accountability, transparency and financial management reform in the country.

Capacity Constraints

In the context of a low income post conflict country; achievement of development objectives through enhanced capacity is not easy for Nepal. Capacity improvements in terms of PFM reform may include human resources, institutions, legal framework and accountability mechanism. Professionalism in Nepal civil services is considered as above the South Asian Countries average, but it is highly politicized requiring optimal use of its knowledge and skills for achieving higher development results.

Lower capacity of Nepal to introduce more advanced reforms based on technology and innovation need support from donors. Capacity enhancement is a necessity to achieve success in PFM reforms. In case of some donor-funded projects the capacity enhancement component is built in. But government funded projects remain weak in terms overall PFM capabilities. In the areas of sophisticated investigation and scrutiny and reforms requiring implementation of ICT knowledge base, the local capacity is severely limited.

The Evolution of PFM reform in Nepal

The government that came into power through election after the restoration of multiparty democratic system in 1990, enthusiastically embarked on economic reforms adopting liberal economic policy including reforms in Public Financial Management (PFM) system. The paradigm shift both in politics and economics inspired the people with the hope that Nepal can pave the way for modernization and development.

Economic reform agenda was led by the higher political level covering policy and institution and also supporting private initiative targeting on government budget, good governance, social services and basic infrastructure. Economic reform policies and programs were directed more towards liberalizations, privatization, decentralization and poverty reduction. This 'new wave' of reform initiative was a global phenomenon.

Interestingly, most of the PFM reform assessment and exercises in Nepal were initiated during the period of insurgency viz. Immediate Action plan (IAP) 2002, Public Expenditure Review Commission (PERC) 2000, Country Financial Accountability Assessment (CFAA) 2002, Medium Terms Expenditure Framework (MTEF) 2002 and Country Procurement Assessment Report (CPAR) 2002.

Besides these the other initiatives include the Gap Analysis of Public Sector Accounting and Auditing 2007, Public Procurement Act 2007, PFM Strengthening Basics Systems 2010 and Improving Budget Executions, Fiscal Reporting and Cash Management 2012. The most significant was the PEFA assessment conducted in 2007 covering Fiscal Year 2005/06 period.

Nepal's experience reveals that though the politics plays the vital role in PFM reforms but once the political goal is set it is the bureaucracy that could take the lead and bring significant results in many issues related to process and implementation, if they have the mandate. The elusive political commitment without adequate space as well as the mismatch of reform activities could make the result poor. Bureaucrats and technocrats can contribute for the continuity of PFM reform initiatives and also provide technical solution, if required during implementation, though the improvement may not meet the expectation.

PFM reform agenda is often associated with reform in civil service. Reform in technical issues followed by legislation, institution and capacity to improve accountability should be the motto; however the lack of compliance is the problem. Automation and modernization such as IFMIS play important role for PFM success. If we ignore the non technical issues that include politics, institution and society in a broader perspective, technical input may contribute only a little.

The operational risk assessment study on PFM reform in Nepal recently carried out by the ODI emphasizes basically four key areas for reform that include enhancing accountability through strengthening of the OAG and establishing internal audit cadre. The second area is fixing the budget process to improve credibility through clear division of role between the NPC, the MoF, the FCGO, line ministries and local bodies. The Third area suggested for reform is the improvement in implementation of Capital projects ensuring timely budget process, technical and institutional support to local bodies, strengthen competition in public procurement and establish minimum technical standard to enhance contractors' service delivery. The fourth area is to strengthen coordination between central finance institutions. This report further emphasizes for joint political outcomes, use of professional bureaucracy without political interference and inter-entity coordination.

Public Expenditure and Financial Accountability (PEFA)

PEFA launched in 2005 is a diagnostic tool that covers the key elements for improving PFM system. PFM indicator are set and performance is evaluated based mainly on clarity on government responsibilities, information access to public, budget cycle undertaken in an open manner, assessment of donor practices and assurance of integrity through oversight agencies.

Special circumstances of post conflict countries largely share the common feature like fragile social structure, divergent views among fragmented political parties, particularly in state restructuring and thus the government needs attention in PFM reform strategy accordingly. The role of donors is also crucial for Nepal in post conflict reconstruction aid package that needs to be owned by the national authorities. At the same time, the aid package should help build legitimacy and state effectiveness for the sustainability of the peace process.

Various weaknesses in PFM system have contributed to maintain the overall fiduciary risk at high. Among the main PEFA indicators, credibility of the budget has declined due to low capital expenditure and fiscal activities outside the budget. The PEFA indicator on policy based budgeting, characterized with poor cash planning, expenditure management and revenue forecast has the gaps and similarly, budget execution entangled with delay in disbursement and procurement issue resulting to time and cost escalation has increased the risk. The accounting and reporting indicator reveals the issue of reconciliation along with unsettled irregularities shown by the OAG report. The external scrutiny and audit indicator reflects that non existence of PAC and Finance Committee of the Parliament resulting to inability for audit report review has increased the risk. However, GON initiative to follow up the OAG report by the cabinet committee chaired by the finance minister is a positive effort.

PEFA steering committee chaired by finance secretary and working committee chaired by PEFA coordinator was formed in 2009. Similarly PEFA implementation units are also in operation both at centre and local level. The GoN intends to carry out second PEFA assessment to be completed by 2014 so that the weakness in PFM system can be addressed and effectiveness of the state can be enhanced. The main objective is to assess the PFM system, update the fiduciary environment and identify the weaknesses that need further reform.

Development Partners' Engagement

Foreign aid comprising of about 25 percent of national budget plays key role in Nepal's socio economic development. About 40 countries are providing aid to Nepal emphasizing commitment, institutions, coordination and effectiveness; however, in practice the development partners need to align with government national plan and programs. Now, about 45 percent of total aid is channeled through government system. More specifically, a large amount of foreign grants in the form of technical assistance, direct payments, commodities grants and turnkey projects that finances the procurement of goods and services abroad is bypassed from the budget process, sometimes creating the issue of transparency and accountability. The OAG report of 2012 has mentioned that such assistance amount has reached Rs 62 billion which is outside the purview of audit. The assistance amount that has come under audit is nearly only Rs 52 billion. Now the government is drafting new foreign aid policy to incorporate all the grants from development partner through the formal window of budget.

Foreign aid in the form of budgetary support, though it carries stringent condition is preferred by the recipient countries because of fungible nature which can be used for maintaining budgetary balance. Furthermore, the tradeoff between Nepal's limited capacity for reform and donors' push with certain strings sometimes to implement advance reform without considering the impact of spending and the domestic need may create problems. Similarly, overstretching the national capacity donor driven reform agenda in the priority resulted to less success. Picking up the problems from a shopping list derived from ‘best practices’ dominated the PFM reform process instead of looking at ground reality. Similarly, our efforts to take the lead in preparing PFM strategy as well as in budget execution seating in the driver’s seat was not much achieved. The main reason for such scenario was due to our larger dependency upon the donors’ resources for capital expenditure. Therefore, domestic need and national leadership should dominate the PFM reform for effective outcome rather than donors' push. However, joint efforts could contribute a lot. Similarly, the aid modalities, absorptive capacity and level and period of donors' engagement equally influence the outcome. Instead of quick fixing, donors’ concentration on downstream reform processes with a longer association may help.

Budget reform and development outcomes

There is a strong link between budget reform and development outcomes. The linkage between the key PFM reform functions and the achievement of common development objectives viz. macroeconomic stability, resource allocation, good governance and service delivery eventually contributing to state building needs to be assessed considering the domestic realities. Pushing up PFM reform without domestic capacity could increase dependency on development partners.

Politics of budget is associated not only with developing countries like Nepal but also with developed countries irrespective of the system of government and the status of stability. The main reason behind such scenario is due to the availability of authority through budget for effective and important policy and development intervention.

The contribution of reform initiatives in achieving development objectives can be assessed through a range of prioritized PFM functions. Prioritization is necessary, without it the reform initiative could turn into a mess. The link between budgetary reform and development outcome demands assessment based on ' ground reality' of country's logistics and capacity rather than replicating the so called ideal success story developed in different political, economic and social environment.

Nepal's experience in managing public resources through national budget has become problematic because of over programming, lack of prioritization, minimal and scattered allocation and lack of ownership. Similarly, weak institutions, poor capacity and absence of proper sequencing were the other areas that hindered the implementation.

The 'budgetary basics', ‘institutions' and 'external environment' such as societal and private norms need consideration in the sequencing of PFM reforms. The constraints identified needs to be transformed into opportunity pushing forward the easier reforms first followed by difficult and advance reforms. The ‘basics’ include effective control of inputs, accuracy in cash based accounting and effective financial audit and the ‘platform approach’ that advocates packaging of reforms in a sequence and specified time frame are both in debate.

It will be relevant to mention here that the IMF, the World Bank and the EU put pressure on Nepal to enter into HIPCs initiative during the peak period of insurgencies but Nepal resisted the pressure and assured donor to initiate national measures without entering into HIPCs. Most of the major donors at that time were reluctant to accept the national initiatives which were largely based on budgetary reforms. But the results reveal that the national initiative brought substantial improvement in debt scenario and to maintain macroeconomic stability. (See Annexure 1)

Nepal's experience relating to templating best practices is not encouraging; however, it could be a basis for peer comparison of a PFM reform plan. For example, the MTEF- an advanced component of PFM to link policy with budget implemented in 2002 with the initiative of Ministry of Finance, National Planning Commission and a few development partners became nonfunctional within few years because of poor ' basics', ' low capacity' and particularly the weak 'sectoral strategy'.

The Government of Nepal during PEFA assessment has mentioned that it will adopt ‘platform approach’ in implementation of reforms. This ‘platform approach’ includes predictability of fund, evidence based management, stronger accountability and performance based orientation. However, the rational approach will be to adopt logical, sequential and country led approach.

Though the basic PFM system in Nepal is in place but the systemic weakness in budget preparation, execution and informal influencing practices largely prevails. The success of PFM reform largely depend on the lead role played by MOF in preparing PFM strategy, need to focus on the real issue rather than picking up from a shopping list and also be selective. However, participation of line ministries, CSOs and parliamentarian is equally important. Importance of civil society participation in all stage of PFM process including budget enhances the probability of success. To be more specific, GoN need to internalize the PFM reform process through national professionals and citizen’s participation. Similarly, the reform initiative should go beyond MoF including sectoral ministries, oversight agencies and local bodies.

Macroeconomic Stability

Prudent system of financial management minimizes the vulnerability to external shocks and increases the prospects of sustainable growth. Low inflation, low interest rate, low national debt, low deficit and currency stability are the variable in general to measure macroeconomic stability. Government monetary, fiscal and financial activity substantially affects macroeconomic stability. Furthermore, fiscal deficit and debt management directly contributes for maintaining macroeconomic stability. In Nepal, insurgency was at peak during 2002 to 2006, and in 2006 peace agreement was signed. Major macroeconomic indicators of insurgency period, conflict peak period and transition period reveals the following facts.

PEFA assessment of Nepal covers the period as of fiscal year 2005/06. The conflict was in peak level during the PEFA assessment period i.e. 2003/04, 2004/05 and 2005/06. Despite lower economic growth, declining foreign aid, increasing expenditure requirement for security and debt repayment the macroeconomic stability was maintained and the country was saved from the fiscal downturn. The average fiscal deficit was contained in 3.5 percent of GDP, Public debt brought down to 51.6 percent in 2005/06 from 70 percent in 2001/02. Total external debt has been reduced from 53.4 percent in 2001/02 to 35.8 percent in 2005/06. Average total expenditure was contained to 17 percent of GDP. Government revenue maintained at a level of 12.0 percent of GDP.

Looking at the data on macroeconomic indicators (Annexure) significant positive change can be noticed in debt /GDP ratio that has come down to less than half i.e. from 62.6 percent in 2002/03 to 51.6 percent in 2005/06 and 30.1 percent in 2012/13. Furthermore foreign debt/GDP came down from 45.4 percent in 2002/03 to 35.8 percent in 2005/06 and 17.6 percent in 2012/13.

The other area of improvement was the revenue that reached to 17 percent of GDP in 2012/13 from 11.4 percent in 2002/03. Introduction of VAT, new income tax legislation in 2002 and continued institutional reform in revenue administration was the main reason for the improvement in revenue collection. Remittances income has doubled from 11 percent in 2002/03 to 22.4 percent covering 56 percent of the household in 2012/13.

Most of the other indicators show that they are almost constant or have further deteriorated during the post conflict transition period. For example consumer price index has increased from 4.7 percent in 2002/03 to 10.6 percent in 2012/13. In the same period, government total expenditure to GDP has risen from 17.1 percent to 23.8 percent, recurrent expenditure increased from to 10.6 percent to 16.4 percent of GDP. Capital expenditure decreased from 4.5 percent to 3.9 percent of GDP in 2012/13. Budget deficit in 2005/06 was 3.8 percent now in 2012/13 it is 3.7 percent of GDP.

From these scenario basically two lessons were learned, first the national initiatives targeting to maintain fiscal discipline including PFM reform, of course with the support of donors could be effective, and secondly donors' conditions may not always bring improvement in the system, if domestic realities is not considered. Thus, a review or flexibility on the standard followed by the development partners on PFM reforms needs to be adhered as per the requirement and capacity of the recipient country.

Resource allocation

Efficiency in resource allocation and use ensuring accountability and transparency through a sound PFM system is essential for sustainable economic growth. The resource allocation that maximizes social welfare consistent with the need of the society is considered as an outcome of improved PFM system.

The PFM reform is a challenging issue dominated by the objective of control and accountability and is also influenced by politics, however, the importance of efficiency in public resource allocation and use which serves the national objectives of achieving development outcome cannot be undermined.

Credibility of the budget can be enhanced through greater allocative efficiency. Efficiency in budget allocation is difficult to measure however, more transparent and evidence based methodology can be followed in allocation decision. In Nepal, Poverty Reduction Strategy Paper (PRSP) and the national development plan provides the national priorities to reflect in the annual budget. PFM reforms can provide timely and accurate information on the one hand and also provide room for allocation in line with national development strategy.

Reliable information and structured budgeting process is necessary for efficiency in resource allocation. Resources allocation function is influenced more by politics, patronage and donors condition than the PFM reforms. The advance PFM reform measure like performance budgeting and MTEF to improve efficiency in resource allocation due to capacity constraints in our case has not succeeded. The linkage between prioritization of projects, expenditure and sectoral policy is weak.

The absence of budgetary laws or unimplemented budget rules and guidelines, cumbersome procedures, fragmented budgetary process has hindered the reform process. The budget cycle comprises of formulation execution, accounting and reporting, and external scrutiny which needs attention specifically on execution, though other areas are also weak. Nepal's budget are 'made better than they are executed' as it is in other developing countries. The budget execution faces the problem specifically on implementation of capital projects, management of contingent liabilities, public procurement, in-year changes in the budget and fiscal transfers.

The operational risk in the PFM system of Nepal has increased due to delay in budget preparation and execution. Similarly, non-budgetary expenditure is increasing; capital budget is largely spent at the end of the fiscal year. Furthermore, virement rules, under execution and fragmentation of capital budget are in common and prioritization process is also faulty.

Services Delivery

A better PFM system will contribute to overall services delivery mechanism of government. Nepal's experience particularly in health and education reveal the improvement in delivering of some key commodities and services despite the national weak capacity. The sector wide approach adopted in health and education to some extent reflects the success. The inputs required for outputs may vary depending upon the nature of services provided to the citizen. The incentive structure including timely wages provided through PFM reform reflects the success improving motivation and morale of the staff of education and health sectors.

PFM reform supporting planned investment and spending could enhance service delivery performance indirectly, if the reform is broad based. Government largely intent to pay high priority in maintaining fiscal discipline and ensure accountability measures rather than in service delivery. PFM reforms contribute to service delivery outcomes indirectly, if the expenditure inputs along with programs and institutions are in place.

The modalities of the delivery also count. From our experience empowerment of the people at grassroots level could bring encouraging result. The community based approach in forest regeneration through forest user groups and reduction in infant and maternal mortality with the help of mothers' groups are the examples.

Despite high poverty, conflict and political instability Nepal's health sector is moving toward right direction to accomplish the MDG. The maternal mortality has declined to 229 per thousand and infant mortality has also significantly dropped. The main reason is the policy prioritization, strong reach out in remote areas and substantial increase in health expenditure. Health expenditure per capita almost doubled in 15 years reaching US$66 in 2010 with the significant support from the donors. The experience of Nepal particularly the program aspect in reducing maternal mortality can be a good lesson to share with other countries. But, from the perspective of oversight agencies the resources used are not beyond questions.

Governance

PFM reform associated with governance affects accountability, authority, decentralization and government action. The role of PFM reform in state effectiveness is largely looked upon only from the perspective of improving technical aspects process and procedures. However, it is vital to recognize the important contribution made by the governance in development outcome, and thereby state building through PFM reform. Therefore, a functioning system of PFM reform strengthening the link between government officials, parliament, and the Office of the Auditor General and citizen increases accountability.

Similarly, PFM reforms enhancing coordination across government institutions for check and balance of power contribute to state building. Moreover, PFM reform increasing participation, decentralization and transparency through access and dissemination of information contribute to enhance credibility of the government and thus state effectiveness.

Transparency International ranks Nepal at 139th position in corruption perception Index of 174 countries in 2013. Open Budget Survey 2012 reveals that Nepal is poor in basic standard of budget transparency and fiscal activities. Nepal scored 44 out of 100, which is marginally higher than the average score of 43, but it has dropped in ranking. In 2010, Nepal scored 45 but slipped to 44 in 2012.

State Effectiveness

PFM supports for enhancing state effectiveness through improved revenue collection, efficient resources allocation, improved transparency, accountability and governance. Similarly, it will contribute for effective service delivery and sustainability in public finance policies enhancing the state credibility.

The public sector as a whole and the bureaucracy in particular is comparatively capable of implementing reforms. But the PFM system has yet to deliver because of differences emerged between major political players during post conflict reconciliation.

On the background of unstable politics, political parties divided on ethnic and regional interest, low rate of economic growth, poor governance and service delivery the development challenge in Nepal is enormous. However, the resources and strategic location if utilized with increased investment in infrastructure the growth potential of Nepal is high.

At the moment, Nepal is awaiting for state restructuring. The constitution is interim; the parliament is just in place; and local bodies are operated by civil service since last 14 Years. The budget process is beyond reach of general people because of the absence of elected bodies at local level. The role of oversight agencies have been diluted weakening the accountability mechanism.

Even in such difficult situation some significant development outcome has been achieved in few areas. Success towards MDGs in health sector and reduction in poverty to 23.8 percent in 2012, improvements in basic infrastructures and education are remarkable achievements. The specific reform observed in PFM system mainly comprising of adoption of bottom up approach in development planning, maintenance of macroeconomic stability and introduction of Treasury Single Account (TSA). The introductions of TSA help achieve real time data, more realistic budget forecast and better cash management. The Nepal Financial Reporting Standards (NFRS) based on International Financial Reporting Standards (IFRS) is being implemented by ICAN, and a new Chart of Accounts, multiyear contracting of P1 projects, e-tendering, adoption of Nepal Public Sector Accounting Standard (NPSAS) under cash basis and adoption of INTOSAI audit standard are some of the other achievements. Institutionalization of

NPSAS being piloted in two Ministries and execution of NFRS also need consideration. A National Institute on PFM could help improve capacity. Despite some progress, the overall fiduciary risk is considered as still high.

Challenges

The challenges that need to be addressed in the PFM reform of Nepal with the objective of state building, poverty reduction and sustainable economic growth enabling through a sound PFM system may include briefly as follows.

In the first place, the post conflict unstable politics must come to an end along with the election of CA/parliament on November 19. The fragmented views among political parties specifically on the key issues of state restructuring and government creating complication may further prolong transition resulting to failures in managing the transitional hazards.

Secondly, maintenance of macroeconomic stability along with achieving a higher rate of growth in a sustainable manner will be a crucial challenge ahead.

Thirdly, establishment of strong linkage between national development goals with sector strategy through medium term fiscal framework seems to be difficult immediately because of fragmented politics and uncertainties.

Fourthly, improvement in budget execution through PFM strategy could be a key element to increase accountability and reduce corruption. Efforts for meaningful implementation can address governance problems. However, the budget execution challenge seems to remain for some time. Similarly, issues related to donor coordination and harmonization may continue.

The fifth, improved service delivery with increased flow and predictability of budget may enhance credibility of the government, but due to resources constraints this will remain as a challenge for future too.

Sixthly, during the state restructuring process the role of PFM for effective use and allocation of resources within the Federal system need consideration.

Finally, the oversight agencies need to be strengthened pursuing the formal mandate of the organization.

Evaluation of PFM reform progress at a regular interval needs to be carried out with the parameters including increment in domestic accountability, reduction in corruption, sustainability of reforms, achievement in MDG and use of country system by the donors. Furthermore, service delivery, civil services reform, procurement and pay roll reform could be other areas for evaluation.

The way forward

Nepal in political transition is in need of a framework that manages fiscal and financial issues for sustainability of peace and also achieving for a higher rate of economic growth. Building of an effective state ensuring service delivery with sustainable growth requires enormous efforts and resources. Higher economic growth, political stability, stronger domestic revenue base, reform commitment and accountable and responsive bureaucracy are the pillars for PFM success.

Nepal needs to move with the PFM reform agenda targeting to achieve development outcome through sustainable fiscal policy, improved service delivery, good governance and capacity development. The success of the PFM reform agenda will largely depend on strengthening of institutions including oversight agencies and coordination and meaningful alignment with donors. To sum up, fixing the budget process, strengthening the oversight agencies, implementing capital projects, strengthening coordination between central finance institutions and adopting inclusive development strategies are the key areas that need utmost attention.

ANNEXURE - I

Major macro Economic Indicator

	2002/03	2005/06	2012/13
GDP Growth percent	3.8	3.7	3.6
Per capital Gross National Income US$	261	352	721
Total GDP at Current prices Rs billion	492	654	1701
Gross consumption /GDP percent	91.4	91.0	90.7
Gross National saving GDP percent	23.8	29.0	38.4
Consumer price index percent	4.7	8.0	10.6
Total Revenue /GDP percent	11.4	11.1	17.0
Total Govt. Exp./ GDP percent	17.1	17.0	23.8
Recurrent exp./GDP percent	10.6	10.2	16.4
Capital exp./GDP percent	4.5	4.5	3.9
Debt servicing /GDP percent	3.3	3.1	2.3
Budget deficit /GDP percent	3.3	3.8	3.7
Foreign grants and loans received /GDP percent	3.2	3.4	2.8
Total outstanding Debt /GDP percent	62.6	51.6	30.1
Foreign Debt /GDP percent	45.4	35.8	17.6
Remittances income /GDP percent	11.0	14.9	22.4
Average exchange Rate one US dollar/Rs	77.8	72.3	87.1

Source: Economic Survey, 2012/13, GoN, Ministry of Finance

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TRADE- BASED MONEY LAUNDERING: Nepal's Experience

MUKTI NARAYAN PAUDEL, Ph.D.[2]

Abstract

Trade based money laundering in Nepal is rampant. Its control will create peaceful and just society. For this political consensus and honest implementation of prevailing laws is must. Creation and use of national integrated IT system of every individual's property and all activities will generate real information for prompt actions.

Definitions

Trade is the exchange of goods and services. It takes two forms- inland or domestic, and international or foreign. The exchange of goods and services within the regions of a political boundary is domestic trade, and if this exchange takes place beyond the political boundary or across the political boundary, it is foreign or international trade. Trade may both legitimate and illicit trade in goods and services. Trader (facilitator) may be both individual and organized unit as corporation, business firm, etc.

Converting of illegal earnings from crimes, such as corruption, smuggling, illegal arms sales, drug trafficking, human trafficking, banking and financial frauds, robbery, extortion, kidnapping, illegal fund raising and donations collections, embezzlements, frauds etc., into legal one is generally called **money laundering**. The use of illegal earnings, converting into other forms of assets, transferring such earnings abroad, use of such illegal proceeds in financing projects such as infrastructures development, in buying land, houses, vehicles, jewelleries, shares and equities, insurance schemes etc. on their own, or on their companies, or on their relatives names are acts of **money laundering** (Paudel, 2012)

[2] Mr. Poudel is Joint Financial Comptroller General in Financial Comptroller General Office and Coordinator in PEFA Secretariat, Nepal.

Trade-based money laundering (TBML) is defined as the process of disguising the proceeds of crime and moving the value through the use of trade transactions in an attempt to legitimize their illicit origin or finance their activities(FATF, 2008a:3). TBML is the use of trade to legitimize, conceal, transfer, and convert large quantities of illicit cash into less conspicuous assets or commodities (International Narcotics Control Strategy Report, 2004:21). Thus TBML is the use of trade to move value with the intent of obscuring the true origin of funds. It is also called an alternative remittance system allows illegal organizations the opportunity to earn, move and store proceeds disguised as legitimate trade.

Trade-based money laundering (TBML) techniques

TBML techniques range from simple fraud, such as wrong declaration or misrepresentation of the price, quantity, quality of goods on an invoice, through to complex networks of trade and financial transactions. The main TBML techniques may as:

1. Trade description fraud, which may comprise one of the following techniques:

   a. Over- and under-invoicing: - This technique is applied for the misrepresentation of the price of goods or services to transfer additional value between the importer and exporter. Invoicing the good or service at below the fair market price enables the exporter to transfer the value to the importer. Similarly, invoicing at above market price enables the exporter to obtain a higher payment. In former case, the exporter may deposit the earned money abroad or in the account of importer, in latter case, exporter may receive illegally earned or previously concealed by both parties or by exporter.

   b. Multiple invoicing:- The same good or service is invoiced more than once, often using a number of different financial institutions to make the payments, and transferring the illegally earned money abroad or in others account.

   c. Over – and under–shipments:- By overstating or understating the quantity of goods being shipped or services provided, the export and import prices are manipulated, and money is transferred.

d. Non-trade banking transactions:- Without any actual supply of goods and services, there may only paperwork agreed by the importer and exporter, e.g. commercial invoices, bills of lading, shipping documents are prepared to support the fraudulent transactions. The Dollars transferred to Honkong for wool or other imports, or Indian currency taken from and deposited with Nepali Commercial Banks and drawn in India, are the examples. The fictitious documents of Nepal's export from Rasuwa point to Tibet were prepared with the aim of receiving a Value-added tax Refund, and the refund was provided.

2. False/wrong declarations: - When a relatively inexpensive good is supplied it is invoiced as being more expensive, of different quality, or even an entirely different item so that the documentation does not accurately record what is actually supplied. e.g. money transferred for stones dust with soil mixed, or plastic wastages shipped instead of chemical fertilizer Coal instead of other goods through post parcels, etc. Or, terrorist goods may be imported showing other daily necessities, or legal goods.

3. Related party transactions: - Related party transactions are the transactions between entities that are part of the same corporate or business group. This transactions make easier to conduct and more difficult to detect as it is done in-house. Different tax rates and incentives encourage international or national companies to move funds and assets within the group. Transfer pricing is used, as part of the group financial and tax planning, to shift taxable income from jurisdictions with relatively high tax rates to jurisdictions with relatively low tax rates to minimize income tax.

4. Acquisition and sale of intangibles: - Fraud is difficult to detect and prove in case of trade of services. Intangible nature of services, and less likely to be standard makes supply determine difficult. It can be difficult to determine the fair market value of services, e.g. financial advice, consulting services, market research, computer works, etc.

5. Shell and front companies: - These two types of companies facilitate TBML So, thorough scrutiny is needed while doing trade and other trade related agencies like customs, commerce offices, banks, etc. should be more cautious about the foreign

trading companies' export and imports, and their invoices and money transfers. A Shell company has no real operating activities and is used to hide money laundering activity and the identities of individuals involved to obscure the money trail. While a Front company is a real business whose legitimate operations are used as a cover for money laundering and other criminal activity.

6. Illegal/smuggling trade:- Sole purpose of this trade is for money laundering. The documents kept are not submitted for tax purpose. There may mix of legal and illegal goods for trading in local market. Thorough search and audit, and compulsory billing can help find whether the trade is on legally imports and exports.

7. Over- and under-statement of domestic products:- Statement of products from local manufacturers also helps TBML, Showing low products than actual means showing low inputs, or showing higher wastages, leading more income from exfactory products and concealing the income using other techniques of transfer of money.

8. Trade on contrabands:- Earning from trade on legally prohibited goods, flora and fauna products/remains, archaeologies, is solely for money laundering.

Factors helping of TBML

Open border of Nepal is seen more helpful for smuggling goods and transferring money abroad. The collusion among politicians, bureaucracy, and smugglers for corruption and thereby hoarding money is the most critical factor. Mediation in all spheres of public services for corruption under political guardianship is an inhibiting factor in creating just society. Use of legally permitted professions for hoarding and siphoning money through fake documentation, smuggling, concealing income from fraud businesses; non-enforcement of tax and banking, procurement laws for compulsory banking transaction; use of monetary instruments like–travelers cheques, ATM cards, etc.; extortions by kidnapping, horror and fear creation; illegal professions like trade on contrabands, parts and remains of and products made from legally banded faunas and floras, drugs, etc.; lack of modern equipments and technologies for checks and screening of goods; lack of physical facilities like laboratories for tests, layouts of customs, immigrations, quarantines; are helpful factors for TBML.

Ways for controlling TBML

Effective border control/management, monetary management, information sharing – through IT system, investigation- of actual and probable cases, intelligency, post-search of risk areas and probable cases, legal enforcement like billing of every transactions, enforcement of transactions through banking channels, creation of infrastructure for quality control, IT system, office layouts, customs yards management, effective immigration system, will help control of TBML. Harsh action against money laundering and corruption is a must for control TBML. Creation and use of National ID containing national integrated data of all individuals of their property, doing businesses, employment, investment, profession, licenses, etc. will be most useful for action.

Conclusion

Enforcement of legal provisions of laws relating to customs, revenue administration, trade, monetary, bilateral arrangements, asset, other administrative and security, taxation, banking, foreign exchange, foreign and domestic investments, is the need of the day.

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Towards Setting up of a Dedicated Debt Management Office in Nepal

- **Mr. Rajendra Bajracharya**[3]

Contextual

Nepal has been predominantly relying on domestic and foreign debt for budget deficit financing and we are very much aware of the increasing trends of these debt liabilities and its service charges over the years. It has also increased our concerns on the risk followed by the increasing trends of debt liabilities which has raised the issue of debt sustainability and solvency and ultimately economic stability. However, the larger financing needs has created awareness of the significance of debt management operations to long-term fiscal sustainability and efficiency and effectiveness of the public financial management. The increased complexities of debt management with its financial markets and the instruments have led to awareness of the need to professionalize the debt management function to manage such complex debt portfolios.

Debt management is framework, system or process through which government collect funding resources to meet the budget deficit. The main goal of debt management is to ensure that the government's financing needs and its payment obligations are met at lowest possible cost over the medium to long term, consistent with a prudent degree of risk. (IMF and the WB, 2011).

The overall policies, laws, rules and regulations, institutional arrangements governing the debt management, financial markets and government securities have been inadequate for development of a vibrant bond market in the country for meeting long-term financing requirements for construction of New Nepal. Country's economic growth remains less than expected over the years and the one of the main cause behind this situation is lack of strategic and optimum utilization of resources including public debt.

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[3] Mr. Bajarcharya was worked as a Coordinator in PEFA Secretariat, Nepal.

Presently, in Nepal's scenario, we have dispersed or fragmented approach of debt management innate numerous disadvantages and negative results such as absence of debt management strategy, management of inherent risks, coordination on debt raising, consolidated debt database, debt sustainability analysis (DSA), etc. It also adhered many problems like low priority of debt management, lack of trained staffs and frequent transfer,

In these contexts, strengthening public debt management is crucial. There is need of a dedicated and professional centralized body handling entire scope of public debt management functions or operations more effectively and efficiently. So, it is necessary to focus on reform initiatives in different policies, institutional, processes and operational aspects related to public debt management in Nepal.

Need of integrated approach to debt management functions makes a number of reasons.

- To make separation between monetary policy and public debt management,
- Need of consolidating dispersed or scattered debt management functions within an entity,
- DMO is globally accepted best practices,
- DMO focuses on operating debt management functions more accountable and transparent,
- To eliminate the risk of overlapping and duplication of debt management and operational areas,
- To make clear provision of public debt policies, strategies, programs, action plans with its clear authority and responsibility to a single entity,
- Need of conducting debt sustainability analysis in regular by ourselves,
- Need of professional managers and personnel to handle and manage public debt management functions effectively and efficiently,
- Consolidating segregated acts and regulations to a single Public Debt Management Act and Regulation
- Consolidating scattered operations, accounting, recording, reporting, auditing and accessing information functions regarding public debt management.

- To coordinate debt and cash management so that debt issuance decisions are made in the sense of government's overall cash flow.
- Need of management of key risks inherent to government debt portfolios.
- To use significant tools e.g. Medium-Term Debt Strategy (MTDS), Debt Management Performance Assessment (DeMPA), for guiding debt management operations.

Framework for Debt Management Office

The operational debt management functions are distributed to different three levels of offices as front, middle and back offices.

Front Office functions consist of resource mobilization or funding and policy decisions on raising foreign and domestic borrowings based on annual budgeting structure. It also includes setting & application of guidelines, foreign loan negotiations & agreements, domestic debt raising, making cost effectiveness of debt, on-lending and guarantee operation functions. These functions are performed by Ministry of Finance. The functional part of domestic debt auctions and its roll-over has been done by Nepal Rastra Bank.

Middle Office functions consist of undertaking portfolio analysis, selection of debt management strategy, monitoring the performance of front office and functions relating to risk control or risk management, conducting debt sustainability analysis, capital market development, etc. So, the middle office is responsible for analysis and advice on the debt management strategy, which will enable the senior managers to make decisions. It also measures and monitors all loans and conduct policy formulation regarding public debts.

Back Office functions consist of loan operation, making debt service payments, compiling debt database, monitor loan utilization, preparing & maintaining accounts and other reports relating to public debts contracts, disbursements, payments, restructuring, on-lending, guarantee issuance, settlement of transactions, etc. So, the back office is responsible for debt registration and handles transactions confirmations, settlements, interest payments and repayments. It is also responsible for accounts keepings, maintaining records of all public debts transactions and auditing and data consolidation.

Preparing for establishing DMO in Nepal

While preparing for the setting-up of a full-fledged PDMO, it is necessary to review all the functions described as front, middle and back offices which are currently performed by MoF, FCGO and NRB and needs to be merged within it. Certain reforms in legislative arrangements, regulations, institutional, operational processes and procedures are essential to make sustainable functioning of a separate public debt management office (PDMO) in Nepal in the near future. Major review & reforms areas are mentioned below:

Reforms in Legal and Regulatory Provisions

Countries should have legislation that defines the Government’s authority to borrow, invest and enter into financial obligations such as guarantees, hedging and derivative transactions and amortize, redeem or re-purchase government debt. The authority to borrow and manage debt on behalf of the Government could also be included in the broader fiscal legislation with clear provision regarding the accountability and responsibility on public debt management. On the ground of the fiscal legislation specific act or law governing public debt management functions enacted. Presently, there are a number of laws, rules and regulations governing public debt management in Nepal. A consolidated law and regulation is needed to integrate the overall public debt management functions to avoid fragmented operation of debt, ownership of the debt policy and strategies and overlapping & duplication of the debt functions. So, present debt related laws, rules, regulations and provisions should be consolidated in a single law and regulation. Current enacted acts and regulations are as follows:

- Loan and Guarantee Act, 1968
- National Debt Act, 2059 (2002)
- National Debt Regulation, 2003

- Nepal Rastra Bank Act, 2058
- Rastra Rin Uthaune Ain
- Securities Act, 2063 (2007)

Amendments to these existing laws should be done and the powers and obligations of Nepal Rastra Bank on domestic debt and cash management as an agent for the government should be carefully amended and affected and not to impinge upon the NRB's role in regard to monetary policy, banking regulations and financial stability. The NRB's power and functions related to public debt management need to be removed from the Nepal Rastra Bank Act, 2059. And the authority and functions relating to public debt management should be transitioned to new Public Debt Management Office. The NRB to be assigned to act as an agent of the PMO to perform bank and cash management functions as required by the government authorizes the term of any such agency agreement between the PMO and the NRB.

Reforms in Institutional Arrangements

A separate debt management office with overall operational public debt functional responsibilities should be established under MOF. A professional organization equipped with systematic analytical tools and appropriate professional human capital needs to be installed to carry out debt management policies effectively. The present Interim Constitution provides major mandatory guidelines on public debt but absence the details of the executive and operational functions to be determined by the Parliament and the Cabinet through Acts and Rules. So, it is urgent need to introduce consolidated legislation on public debt management. This law should create an institution to manage public debt at the policy level and operational level. It should clearly define the authority, responsibility and terms of reference of the institution entrusting overall debt functions. All the three levels functions of front office, middle office and back office should be integrated within a single entity. Debt management requires professional specialists while government officials often pursue a different career path and frequently transferring. The staffing of this single entity named as Public Debt Management Office of Nepal (PDMON) could be managed by the concerned working staffs of MoF, FCGO and NRB in its initial stage. Professional staffs should be designated to do the public debt management operations in DMO and they should provide necessary trainings on debt management.

Reforms in Debt Recording & MIS System

There are several agencies involved in public debt accounting and recording functions in Nepal. No unified body existed that could maintain the accounts and records of the transactions of domestic as well as external debts in an standard recording system. Domestic debt records are maintained by Nepal Rastra Bank in their own personal PubSy software and not linkage with the MoF and FCGO in online base. Similarly, FCGO does maintained external debt accounts and records as well as domestic debt records in Excel spread sheets. Auditing of these records are also separately done without proper linkages of debt data sharing for debt analysis. So, there is an prompt need of an unified entity for domestic and external debt accounting and recording in an internationally accepted standard system. A separate computer based debt recording software for domestic and external debt should be developed and used. It is also necessary to make provision of submission of audited annual debt management report to the Parliament for debt data and information dissemination and transparency and accountability.

A debt management information system should be developed and adopted for debt accounting & recording and portfolio management system with required IT professionals. In this regard, CS-DRMS software is needed to be reinstalled, updated and operated by trained staffs. A separate manual on public debt accounting should be developed and followed.

Reforms in Debt Management Structure

The proposed debt management is likely to move away from the present structure managing domestic and foreign debt towards an autonomous DMO. Under this reform, certain practices of debt management structures are mentioned with their basic features.

Structure of PDMO

It has globally been consensus that there should be an autonomous statutory body of a separate DMO; a well-run economy should have a dedicated public debt manager; the Central Bank should not, in general, perform this role; etc. In this context, various models for debt management offices that are best practices in different countries are described as follows:

1. A division or unit within the Ministry of Finance:- In this model debt management office remains as an arm's length of the Ministry of Finance integrating internal and external debt management functions substantially handled by the MoF through department or divisions or units. This model has been followed by Argentina, Brazil, France, New Zealand, US, etc.

2. An executive agency of MoF:- Debt management Office created by the statute with executive authority that manages overall public debt of the country. In other words, the DMO is an executive agency within the legal framework of MoF aggregating debt management functions. This model has been followed by Australia & UK.

3. A statutory body (functioning as an arm's length of Ministry of Finance):- Ireland, Portugal, Sweden:- A statutory body consists the features of operational flexibility, accountability to governments and to the parliament, expertise feature and ability to prioritise public policy objectives. A DMO as a statutory organization governed and set up by an act with the authority and responsibility of borrowing money for the Exchequer and general superintendence of the Minister of Finance & to manage national debt on behalf of MoF. The act make enabled the government to delegate the borrowing and debt management functions of the finance ministry to the specific body. The Chief Executive of this body is directly responsible to the Ministry of Finance.

4. A state owned company:- Establishing government company under the Company Act and Regulations that obligated to register a Memorandum and Articles of Association with the Company Registrar to do the functions of public debt management of the country. The company should work out on its implications of assets, liabilities,

taxations, government's decisions, etc. The government requires strong monitoring and accountability mechanism through company's ToR or Memorandum and Articles of Association conditioning funding provisions, representation in company's board of directors and bound by government's decisions. This model has been adopted in Germany, Hungary, Slovakia where the DMOs are government owned companies.

5. DMO within Central Bank:- This model has been adopted by Denmark, India, etc. Each and every kind of reforms either in the process, institution and system should be done on the basis of long term vision with globally recognized frame work. However, the concept of independent DMO has not been the only model being considered as endeavour to professionalized debt management operations gathered momentum in the current scenarios but also most of the developing and developed countries has followed it. Countries like United Kingdom, Australia, New Zealand, Belgium, Netherlands, Nigeria, etc has followed a separate DMO as agency of Ministry of Finance. Argentina, Brazil, Canada, Chile, China, Columbia, France, Indonesia, Italy, Japan, Korea, Mexico, Russia, Spain, Thailand, Turkey and USA has a separate DMO as a Directorate within the treasury or MoF. Hence, a separate dedicated and unified PDMO in the form of statutory structure will be more effective for our country.

Reforms in debt management functions

In addition, following debt management functions should be reviewed and operated by the proposed unified PDMO:

- Formulate annual borrowing plans consistent with government's budget.
- Monitoring and evaluation of debt strategies implementation.
- Works as a cash manager of government performing cash flow forecasting and manage cash surplus.
- Development of domestic borrowing instruments.

- Functions relating to issuance, auctions, rollover, principal repayment, interest or discounted amount payment, etc. of domestic debt.
- Application of Medium-Term Debt Strategies.
- Formulate and implement policies and guidelines for issuing of government guarantees & on-lending of borrowed funds.
- Recording and reporting of government guarantees and other contingent liabilities
- Risk management functions - review the overall debt portfolio to assess risk, apply available measures to minimize operational risks.
- Conduct Debt Sustainability Analysis.
- Issue foreign currency denominated debt.
- Monitoring development of the government securities market.
- Preparation of International Investment Position of the country.
- Managing foreign currency assets for government transactions required.
- Managing government's policies, strategies and functions regarding overall investments in SOEs and other entities.

Conclusion

Although Nepal has not faced debt stress and has maintained a moderate level of public debt stock with any default in repayment, it needs to consider the urgency of proper management of public debt with necessary reforms according to the global best practices. In the process of reforms in institutions, process and system we should be aware of long-term future perspective. We have already analyzed the negative consequences of the fragmented approach of debt management and the new reform should address those consequences and problems to be resolved with its clear business plans, policies and strategies. In this regard, a separate dedicated Debt Management

Office should be designed and established consolidating overall debt management functions within it.

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A Descriptive Review of Operational Risks Assessment Report 2013 on Nepal's PFM System

Review by Babu Ram Subedi[4]

'Public Financial Management (PFM)-the fine art of budgeting, spending and managing public monies- has undergone a revolution since the late 1980s.'

Cristine Lagarde

Abstract:

The major objective of this article is to make a descriptive review of the Operational Risks Assessment Report 2013 on Public Financial Management Reform in Nepal. This assessment was made by ODI: Center for Aid and Public Expenditure, UK and managed by the World Bank. The study was made by a team of researchers lead by Philipp Krause along with Stephanie Sweet, Edward Hedger and Bhola Chalise. The study applies a 'problem- centric approach' to identify the strengths and problems of public financial management system and practices of Nepal with a view point of the Nepalese governance environment. It has focused on 'dynamic institutional review' method basically concerned with the problems realized by the Nepali officials, politicians, PFM practitioners and civil society organizations working in the field of governance and fiscal transparency.

Based on its diagnostic review of the Nepalese public financial management (PFM) system and practices, the study has concluded that: the concern about the state of Nepalese public finance is best summarized as, "public spending is compromised". *It is due to ineffective oversight and scrutiny, dysfunctional budget process, weak implementation of capital projects, and flawed central*

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[4] Mr. Baburam Subedi is Deputy Financial Comptroller General and Member Secretary in PEFA Secretariat, Kathmandu, Nepal.

PFM institutions. It has also suggested some of the feasible quick-win reforms options along with medium term and long term reform measures. The Main purpose of this article is to disseminate the findings of the study among stakeholders, so that a critical mass is created to implement those very useful recommendations for PFM reform in Nepal.

1.1 General:

The statement made by Cristine Lagarde clearly indicates that there are numerous innovations in public financial management worldwide in the recent days. There are also perennial challenges of managing public finances. Financial or fiduciary risks are some of those crucial challenges. To better understand the true state of public finances and underlying risks, some government have sought to increase the comprehensiveness and coverage of fiscal reporting and accounting and have introduced risk management techniques (Lagarde, 2013).

Most of the risks assessment practices are being conducted by the donor countries and international financial institutions in least developed countries to ascertain the level of fiduciary risks. Operational Risks Assessments are being conducted to diagnose the public financial management problems.

Some of the risks assessment initiatives in Nepal have recently been conducted by the donors i.e. DFID, the World Bank. The next one is of US Aid which is under way. Among them, an Operational Risks Assessment report is recently been published, namely, "Operational Risk Assessment of Public Financial Management Reform in Nepal: a Review of Challenges and Opportunities".(Krause et al,2013) This study is done by ODI: Center for Aid & Public Expenditure in 2012/13. ODI is a Britain based research institution, namely, Overseas Development Institute. This study was conducted by a team lead by Philipp Krause and organized by the World Bank under Multi Donor Trust Fund for PFM reform. The assessment team comprise of Philipp Krause, Stephanie Sweet, Edward Hedger and Bhola Chalise.

1.2 Objective of the Study:

The purpose of the forward looking assessment is to inform dialogue about the implementation of public financial management (PFM) improvement in Nepal, including their prioritization and sequencing in prevailing political context. It aims to provide a 'reality check' on the strengths and weaknesses of of the existing PFM system and focuses nontechnical aspects such as institutional and political factors. (Krause et al, 2013).

1.3 The Coverage and Methodology of the Study:

The study covers, basically, the central budgeting and financial management functions. This also covers local level PFM in two sectors: health and roads. It has tried to analyze Nepalese PFM system in three ways :(i) view how Nepalese PFM system functions in practice. (ii) Identify areas in PFM and related public administration system and where the challenges and operational risks are the greatest, and (iii) point to entry points for PFM strengthening in regard to service delivery.

This study has defined operational risks as 'uncertainties and other factors that may threaten PFM and consequently hinder the service delivery performance'. It is assumed that they may arise from the institutional weaknesses. The study categorizes operational risks in three ways:

i. Inherent risks arising from the scale and complexity of contract administration
ii. Administrative control risks arising from weakness in public administration system; and
iii. Political control risks arising from limited political responsiveness to reported control failure

This study has focused on the combination of bureaucratic and political factors that together determine the underlying constraints to improvement in public financial management.

The study proceeds on a problem driven (or problem- centric) review of the Nepalese PFM system and development of entry points for strengthening its systems and processes with three major viewpoints:

i. Diagnosis of major observed constraints to better PFM
ii. Disaggregation of these factors into tractable problem sets
iii. Develops possible solutions that are compatible with the prevailing context and government policy objectives

    The study was undertaken under the ***dynamic institutional review method*** to assess the operational risks related to PFM improvement in Nepal. Analytically, the ORA is focused on the analysis of administrative control risks that are the most open to direct corrective measures. This review covers the major elements of Nepalese PFM system. Besides, it has also covered the following elements: administrative, socioeconomic and political environment in which PFM systems operates.

    The Dynamic institutional review has covered the following three dimensions:

    i. Assessment of the technical aspects of PFM systems as they currently operates
    ii. Wed the discussion of PFM to an analysis of institutional incentives and capability
    iii. Apply problem- centric approach to analyze both of the systems, rather than trying to measure the *status quo in* Nepal against abstract or unrealistic benchmarks

The PFM system analysis is focused on a description of how the Nepalese PFM system currently works in practice, with an emphasis on the flow of public funds on the expenditure side from the central finance agencies to frontline spending units.

In the case of incentives and capabilities, the scope of analysis is limited to the actors concerned with PFM, their capabilities and their incentive environment.

The issues covered in the report are based not on gap analysis against international best practice, but on problem identified by stakeholders in Nepal. This is the specialty of this study.

It is assumed that problems identified by stakeholders themselves allow for a higher degree of ownership of any possible reforms measures and minimize the contestation. It is also highlighted that diagnosis of the main problems and proposing some inroads will support the government efforts at tackling them.

1.4 The Structure of the Report:

The analysis is structured in nine main chapters. The introductory part covers the objectives of the study, approach and methods. In the chapter two, the environment of Nepalese public finances is analyzed. This covers the analyses of: economic context, donor engagement in PFM and political context.

In the third chapter, institutional arrangements for PFM are analyzed. They include: central ministries, spending ministries, local government bodies and external control and oversight bodies.

In the fourth chapter, policy framework and development planning process is assessed covering national development frameworks, local planning and budget preparation and sector planning especially in health and roads sectors. The fifth chapter focuses on the analysis of budget formulation process: forecasting and planning; and budget preparation process. In the sixth chapter, an analysis of Nepalese budget execution process is made. It covers both institutions and processes; and sectoral and local budget execution processes. The seventh chapter deals with analysis of accounting, reporting and audit. This covers in-year budget monitoring and and reporting, annual reporting and financial statements, internal control and audit, external audit and parliamentary scrutiny and audit follow up. The eighth chapter, most importantly, deals with the diagnosis of the evidences, namely, interpreting the evidence. It has highlighted the strengths and challenges, and problem analysis. Finally, in the ninth chapter, the way forward is presented. This covers:

i. Entry points

ii. PFM reforms and implications for service delivery

iii. Options for external engagement and joint monitoring of progress.

2. The Findings of the Assessment on the Environment of Public Finances in Nepal:

The study has given great focus on the environmental factor of the public finances. It is stated "PFM ultimately cannot be separated from its context, and any assessment of reform process and prospects need to take a holistic view". The study has made a broad overview of of the current economic and political environment, as it is relevant in reviewing the management of public finances in Nepal. It is revealed from the analysis that:

Nepalese economy is still fragile. Remittances have contributed significantly to the reduction of poverty in the past 15 years. Fiscal sustainability is not a significant problem at the moment but there are growing liabilities in the state owned enterprises. And, revenue and expenditure growth has not picked up much since 2008/09, despite higher level of foreign aid.

Foreign aid plays a large role in Nepal's socioeconomic development, representing, a quarter of the national budget, but better information transparency is needed. None of them had provided complete budgetary information. In relation to PFM, there are multiple assessment and diagnostic exercise over the past decade. The MDTF has a clear results framework that links activities and outputs to planned outcomes.

Politically, Nepal is in a polity transition with an uncertain politics and fragmented political system. The accountability and institutional oversight mechanisms envisaged by the interim constitution are severely weakened at present. On the positive side, Nepal's government institutions will play a key role in determining the future of public finance system. Nepal's civil service has been widely reported as cohesive and professional. Comparative evidence suggests Nepal's bureaucracy is indeed highly professional, but not as impartial as its peers.

The main striking point in the negotiations over the new constitution has been the restructuring of the state, including intergovernmental relations.

3. Major Findings of the Study: The Diagnosis Part

The study has traced the operational risks in the PFM system and practices of Nepal, not on the fiduciary perspective of donors but rather government efforts to affect development priorities in the national development plan and sector strategies and fiscal policy objectives of GoN. In this sense, this study is unique than the previous studies conducted in Nepal in the area of public financial management. It has analyzed both the strengths and weaknesses of the PFM system and practices in Nepal.

By interpreting evidence, the study has concluded that" in recent years, progress has been sustained in large part because of the institutional resilience of the civil service. However, this cadre cohesion and strength is itself threatened by atrophy of wider political and bureaucratic governance environment".

3.1 The Strengths or Achievements of Nepal's Current PFM System:

The study has identified some of the strengths or specific achievements of Nepal's current PFM system that had been observed during the assessment process. They are:

i. Continuity of well established formal development planning process.
ii. Maintaining a sound aggregate fiscal management
iii. Introduction and progressive implementation of a Treasury Single Accounts (TSA) system: a significant achievement and a major PFM reform success.
iv. Introduction of new Chart of Accounts in 2011/12
v. E- tendering for government procurement
vi. Adoption of Nepal Public Sector Accounting Standards (IPSAS: cash based)
vii. Adoption of external audit standards(based on INTOSAI)
viii. Credible and consistent positioning of fiscal transparency
ix. New strategy and capacity building program for PFM reform through the establishment of PEFA steering Committee and PEFA Secretariat.

3.2 The Supporting Environment and Challenges of PFM Reform:

The report has also identified some of the positive underlying features of institutional context that are likely to be supportive of reform:

i. A record of political negotiation across parties
ii. Civil service professionalism
iii. Cross departmental coordination

The report has importantly noted that 'these nontechnical strengths are also vulnerable to adverse political influence, which can undermine efforts at strengthening PFM'. This is one of the great challenges for PFM reform in Nepal.

3.3 The Problems:

This assessment has adopted a problem -centric approach. The perspective of the report is that: it has chosen 'dynamic institutional review'. Instead of comparing externally identified benchmarks, this report focuses on the problems with the public finance system as identified by Nepali officials and observers. It is claimed, it can be considered an appreciative inquiry that takes the concerns of government officials as its starting points. It defines problems as the areas of immediate concern with the feature of solvability. In risk assessment, it has focused on administrative control risks in the assumption that direct political risks are outweighed by administrative risks that are more easily amenable to corrective or ameliorative action by public officials.

Based on these grounds, the Operational Risks Assessment report concludes that: the concern about the state of Nepalese public finance is best summarized as, "public spending is compromised." It is stated that 'this is a concern over both quality of every unit spent and failure to achieve quality outcomes and results through the PFM system because of shortfalls in budget execution. This is the main problem as identified by the study. This main problem is broken down into four areas. They are:

I. Ineffective oversight and scrutiny:
It is stated that 'the accountability framework of audit and oversight has been eroded by the vacuum in political governance and is constrained by outdated

audit techniques and skills'. Both external and internal audit are not fully effective. The CA and DDC electoral mandates are expired. Internal audit functions are underdeveloped.

II. Dysfunctional Budget Process:
Budgetary practice in Nepal falls considerably short of being a functional budget process. It is due to the missing legislative budget approval for last few years, annularity is not adhered to in practice, and budget comprehensiveness is undermined by donors and lack of budget credibility.

III. Weak implementation of capital projects:
Capital projects were not well allocated due to political interference to divert funds in lower- priority projects. Weak contracting and procurement, substandard delivery by the contractors and leakage and loss of funds were other reasons.

IV. Flawed central PFM institutions:
Fragmented central finance function, frequent staff transfers and bureaucratic hurdles are indicated the major problems in this category.

The report has stated that this summary of problems presents both challenges and opportunities. They can be the entry points for reforms.

4. The Way Forward or Recommendations of the Report:

The study report has provided a number of feasible entry points for the government and the donor community going forward. It is specifically tailored toward the problem diagram in the report offers a way for stakeholders to immediately initiate activities to address the problems identified.

The beauty of the study report is that it has provided a three elements framework for PFM reform. They consist: i. Reforms entry points for the government, as discussed earlier. ii. PFM reforms and implication for the service delivery, and iii. Options for donor engagement, and joint monitoring of progress

Major recommendations made by the report remain under the four major problem headings: Oversight and scrutiny, budget process, capital spending, and central finance institutions. They are called 'reform entry points' and comprise of:

i. Reinforce Oversight and External Scrutiny:
As a feasible ‘quick win’ reforms measures maintaining of institutional presence and basic capacity of PAC support functions and cadre, review of qualification standards and requirements for local government auditors; and formally distinguish internal audit and treasury roles in DTCOs by establishing a separate sub-cadre of internal audit is needed as a short term reform measures. In the medium term, upgrade of audit skills and risks based audit could be focused. For the longer term reform, simplification of roles and interagency coordination arrangements for OAG, CIAA, NVC and PPMO is preferable.

ii. Fix the Budget Process:
Another ‘quick win’ would be a joint consultative review of inter-ministerial arrangement in budget planning, formulation, and execution to establish a clear roles between the NPC,MOF,FCGO ,line ministries, and local bodies regarding the procedural requirement of budget planning, formulation and execution. There is a need to ensure budget is submitted to parliament a reasonable amount of time prior to start of fiscal year. In the medium term, joint work by MoF, FCGO, NPC and line ministries to ensure spending units have 12 months to execute budgeted spending, and make the Red Book the definitive predictor of actual spending are required. As longer term measures, legality of the budget should be improved through the election of parliament/CA. And, there is a need of improvement in commitments on the use of country system.

iii. Improve Capital Project Implementation:

Government should require that feasibility studies, work plans, and procurement plans be completed and approved before projects enter the budget. As a sustained engagement reforms, strengthening of local government monitoring capacity and link up social accountability capability initiatives, development of national-level norms/rates for project costing, enforcing minimum standards on quality of materials, improvement of technical capacity in monitoring/oversight, and train officials on public procurement are needed. In the long run, strengthening the role of local government bodies in planning and monitoring of capital projects is necessary.

iv. Joint up Central PFM agencies:

The last entry point identified by the study is to strengthen inter-institutional coordination of the central finance function. First, it is necessary to strengthen the analytical, planning, and institutional leadership capability of the PEFA Secretariat to take forward a reform agenda across different agencies. Strengthening coordination function of PEFA Steering Committee is immensely needed. Strengthening the budget leadership role of Budget Division of MOF including its challenge function and strategic budget capacity is required. Protect in-post tenure of the PEFA- relevant staffs positions at MoF, FCGO and other agencies and review of non-financial performance incentives to make key PEFA relevant staffs positions attractive to fill and retain in needed. Joint consultative review of inter-ministerial arrangements in budget planning, formulation, and execution to establish clear division of roles between NPC, MOF, FCGO, line ministries and government bodies is one of the short-term reform measures. As a longer-term reform initiative, there is a need of a fundamental review of role of central finance agencies, which might involve legislative measures.

5. The Associated issues of PFM Reform Initiatives:

As mentioned earlier, the study has analyzed other two important areas of concern. They are: PFM reform and implications for service delivery, and donor engagement options on immediate PFM actions.

5.1 PFM reform and implications for service delivery:

The report has also analyzed the relationship between PFM improvements and service delivery outcomes. It is stated that PFM affects service delivery outcomes only indirectly, so none of the proposed actions should be expected to raise service delivery directly or in isolation. Reinforcing oversight and scrutiny is more likely to strengthen the enabling environment for improved service delivery gradually than to produce a strong, immediate, or specific effect in either sector. Fixing the budget by improving its credibility would support increased predictability and greater smoothening of public expenditures especially for capital investment, operations and maintenance, and commodities. Similarly, strengthening of capital investment projects is high priority for improving the timeliness and quality of construction of new roads, bridges, and health care facilities. Finally, joining up the central institutions to ameliorate the situation of institutional fragmentation and strengthen the function of the MOF would provide a clearer line of sight for central government on service delivery performance. Therefore, the impact of PFM reform might be expected to contribute to improvement in service delivery will have a 'positive indirect effect'.

5.2 Options for External Engagement and Joint Monitoring of Progress:

The ORA report has also recommended some of the ‘donor engagement options’ on immediate PFM actions. It is recommended that, development partners can work with the government in different reforms areas. They need to consider what scope there is for technical assistance and other forms of support. It is stated that, current situation requires external actors to allow space as the government continues to develop its reform agenda. The experience of TSA implementation shows that, even in a situation of considerable uncertainty and potential opposition, the government is capable of implementing technically ambitious and politically challenging reforms. ‘The development partners should consider how best to support government –led initiatives', the report concludes.

It similarly recommends that, in parallel with direct engagement on PFM reform initiatives, development partners and government should develop a set of indicators to monitor progress on PFM. It has suggested some of the PFM monitoring indicators.

While setting indicators, it also has warned to mitigate the risks of moral hazard as they appear with every target- based mechanism. The list of potential monitoring indicators can be only a starting point for a process and negotiation.

It is recommended that, there is a need of a certain degree of flexibility over focus, scope, and ambition. ‘Any form of indicators and targets can be the result only of dialogue between stakeholders and some indicators may be best used for a qualitative assessment on a regular basis without setting any firm target at all,’ the report recommends.

Therefore, it can be concluded from the analysis that reform initiatives carried out by the government and indicator based monitoring emphasis are the iterative processes of dialogue and negotiation.

6. Conclusion:

The major objective of this article is to make a descriptive review of the Operational Risks Assessment Report 2013 on Public Financial Management Reform in Nepal. This assessment was made by ODI: Center for Aid and Expenditure, UK and managed by the World Bank. The study was made by a team of researchers, lead by Philipp Krause along with Stephanie Sweet, Edward Hedger and Bhola Chalise. The study applies a 'problem- centric approach' to identify the strengths and problems of public financial management system and practices of Nepal with a view point of the Nepalese governance environment. It has focused on 'dynamic institutional review' method, basically concerned with the problems realized by the Nepali officials, politicians and practitioners along with civil society organizations working in the field of governance and fiscal transparency. Based on its diagnostic review of PFM system of Nepal, it is concluded that "public spending is compromised". It is due to ineffective oversight and scrutiny, dysfunctional budget process, weak implementation of capital projects, and flawed central PFM institutions.

Before analyzing the problems, the study has indentified the strengths of the PFM system of Nepal widely recognizing the institutional role and professionalism of the Nepalese bureaucracy in spite of the deep political transition. It is stated that in recent years progress has been sustained in large part because of the institutional resilience of the civil service. However, this cadre cohesion and strength is itself threatened by atrophy of wider political and bureaucratic governance environment.

Continuity of well - established formal development process, aggregate fiscal discipline, progressive implementation of TSA, new chart of accounts e-tendering practices and adoption of NPSAS and audit standards are well-spelt strengths of the Nepalese PFM practices, as stated by the study. A credible and consistent positioning of fiscal transparency is one of the merits of the Nepalese public finance system. It has also identified the supporting environment and challenges of PFM reform. The study has identified a number of 'feasible entry points' for the government and the donor community going forward. They include: reinforcing oversight and external scrutiny, fixing the budget, improving the capital spending and joint of Central PFM agencies.

The Main purpose of this article is to disseminate among the stakeholders so that a critical mass is created for implementing the very useful recommendations for PFM reform in Nepal. Because the beauty of the study is that it has given due care of the environmental factors of the public finances of Nepal and has focused on a holistic view. The unique feature of study is that it has traced the operational risks in the PFM system and practices of Nepal, not on the fiduciary perspective of the donors but rather government efforts to affect development priorities in the national development plan and sector strategies and fiscal policy objectives of GoN. Instead of comparing externally indentified benchmarks, this report focuses on the problems with the public finances as indentified by Nepali officers and observers. It has suggested donors to use country system.

In this sense, the recommendations of the study reports are very useful and feasible for PFM reforms in Nepal. The major question of the day is that how to implement these useful suggestions. Commitment of leadership is a crucial factor for this objective. To make these recommendations implemented, the following actions are needed:

I. To take an ownership and necessary decision by the PFM Steering Committee to implement the immediate or quick-win reforms
II. In the medium-term or sustained engagement reforms certain action plan should be submitted to the GON by the committee and reinforcement should be needed by the GON.
III. For the longer-term reform measures, necessary drafts of structural and procedural reforms should immediately prepared.
IV. These actions can be initiated in the participation of concerned stakeholders.
V. Commitment is crucial in every reform.
VI. For the longer term reform

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Knowledge, Technology and Innovation: Sources of Development Drive

- *Subedi Netra Prasad*[5]

Abstract

Technological change has become number one super trend of the time. Accordingly technological innovation is emerging as a leading agent for development in increasingly competitive world. Once the developed countries are moving ahead with their innovation systems and strategies basically guided by government policies and driven by private sector, we the late comers and still adopting traditional ways of production have to move ahead with concrete type of innovation policy and institution in Nepal. In this situation, the experience of Korea and New Zealand can be partially useful to learn from and adopt in our context. Fundamentals of knowledge and innovations as well as locally suitable design principles are important aspects for replicability of innovation. Every sector of the government including financial management needs continuous innovation for better management and outcome. Apart from policies and integrated systems of works, new ideas and way of doing things should be recognized and conducive environment is created even for gradual positive change in the economy.

Key words: Super trends, Innovation, Design Principles, Replicability, Knowledge, TSA.

Background

There are development inputs like capital stock, human resources, minerals, fertile land, ancestral properties and so on for different countries to progress. As the time pass by the demand of time and the level of the competition and cooperation makes the situation different and more complex. In our previous generation, land holdings and number of cattle might be enough to be rich and happy but in our time many new facets of civilizations appear to be the modern and to posses standard life. The determinants of power and influence have been changed from traditional (territory, resources, raw

[5] Mr. *Subedi is currently doing Masters in International Trade from Ajou University, South Korea. He is in the post of Under-Secretary in Financial Comptroller General Office under Ministry Finance.*

manpower and military) to innovative (policies, good governance, effective use of scarce financial resources). Even the agriculture and cattle farming need innovation in their way of doing works. Every spheres of life including government offices, private companies, NGO's, housekeeping, community management need equipments which are available in the global market, otherwise we can neither compete nor cooperate each other. Ideas always keep on evolving and so is the technology. If we provide conducive environment for the continuous development of ideas and apply them in the development of our country that will be gift to the nation and to the world at large. In this short article, discussions are made in the important issue of knowledge, technology, innovation and possible replication of some innovation model in the developing country like Nepal.

Key Resource is the Technology

I prepared very simple questionnaire for mini-research among friends from more than 30 countries studying in Korea with one of the question like this: *"What is the thing in Korea that influence you a lot?"* Now I am getting the response of the questionnaire and the most common answer of that particular question is not other than <u>*TECHNOLOGY*</u>. Yes, technological innovation is one of the major drivers of Korean economic development which transform the poor aid receiving country into advanced donor country within 50 years period. Now we can see every public service delivery here in Korea are digitalized. Every market system is equipped with latest ICT technology. Institutions are integrated and updated regularly. From busy city to remote villages we can find sensor system, CCTV, mobile networks and transport system interconnected in the fare based on time and distance. Koreans are first in the world to use broadband mobile networks. Every year electronic companies of Korea, Samsung, LG produce new generation of electronics putting themselves record keeper in the world market. Every nation should develop innovative capacity in order to catch up the new trends of development.

Edward Cornish in his book 'Futuring' (2004), mentioned about six supertrends shaping the future as follows:

1. Technological progress
2. Economic growth
3. Improvement in health
4. Increasing mobility
5. Environmental decline
6. Increasing deculturation/loss of traditional culture

Adapting with the predictable future is noble task for humanity. And for this environment of innovation is very important in every sector. Moreover, international/ national/regional/local level policy makers should take into account these profound trends in the fast changing world. Technological development should reach to the society at large. It takes time to move from serial number 1 to 7 of the following continuum but without it the innovation remains incomplete:

1. Scientific findings
2. Laboratory feasibility for model development
3. Operating prototype
4. Commercial introduction on operational use
5. Widespread adoption
6. Diffusion to other areas
7. Social and economic impact

Technological progress and innovation is all about growing capability of humans to achieve their purposes. As we look back to forth of human civilization, we can notice series of revolutions like green revolution, industrial revolution, cybernetics revolution, and revolution of biotechnology and nanotechnology. Stage of such revolution may be complete in some advanced countries but in some it has not been started. For example in rural areas of Nepal we are still using plough and oxen to cultivate our land. We are still selling in low prices the unprocessed products. So we can say we are still back in green agricultural and industrial revolution. Yes, some reflections of cybernetics and other technological development also started in some section of our society but we need still to go far to adopt and make it for the public consumption. For this government should have clear cut policy and institutions to foster them regularly.

Some Terminologies Related to Knowledge and Innovation

It is worthwhile to be clear about some terminology about technological progress and knowledge factor associated to it. There are three forms of technological progress:

1. Invention: Creating new technology. Example: Invention of telephone, invention of steam engine, invention of new medicine etc. In context of Nepal, the production of eye-lense by Sanduk Ruit is invention.

2. Innovation: Application of already invented technology in new way. Example: introduction of mobile phone, smart phone, making modern plough needing only one ox replacing the old one which necessitates two oxen. Innovations include both product and process.

3. Diffusion/adoption: This includes massive use of the technology invented and innovated already. The use of polio vaccine, use of community forest conservation groups, development of home stay tourism are not other than adoption of innovation. The simplified use of internet in village area by Mahabir Pun is example of technological diffusion.

Knowledge and innovation are also related to each other. In this connection, following terminologies are frequently used:

1. **Knowledge Creation**: Knowledge creation is the process of coming up with new ideas. The most obvious method of knowledge creation is formal Research and Development (R&D), defined by the OECD as creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and the use of this stock of knowledge to devise new applications. However knowledge can also be created informally, such as through on-the-job idea generation.

Factors influencing knowledge creation within the firm will include the amount of R&D being performed, the effectiveness/efficiency of that R&D, the level of human capital, and the firm's organizational structure and incentives for informal innovative activity.

2. Knowledge Absorption: Knowledge absorption is the process of acquiring knowledge from outside the firm, such as from universities, public research organizations, other domestic firms, or from overseas. Absorption is important because the vast majority of new knowledge is created outside any particular firm. In fact, for a small country like Nepal, the majority of world knowledge is created outside of the country.

Firms can apply some external knowledge immediately, but in most cases they will require some internal capability to (a) be aware that it has been created elsewhere, (b) make sense of it, (c) realize its applicability to the firm, and (d) adapt it to the local context.

Factors influencing knowledge absorption include human capital, R&D capability, linkages with external sources of knowledge (eg, universities, public research organizations, or other firms), and access to embodied knowledge, such as through imported capital equipment. The excludability of existing knowledge for example, in terms of legal intellectual property protection will also have an important influence on knowledge absorption.

3. Knowledge Application: This is final stage of knowledge cycle. Knowledge application is the process of using accumulated knowledge to create value for the firm, through commercialization of a new good or service, or implementation of a production process for example. This process is by no means trivial, and is likely to require different capabilities to those involved in knowledge creation or absorption. For example, good business management, marketing skills, and so on.

Technology is a special type of economic good with properties like non rivalry, partially nonexclusive, cumulative in nature and risk associated with the information asymmetry. So company or person in private sector may not be interested to invest for technology. Once the technology is in used it has spillover effect or positive externalities. So government intervention is necessary at least to create environment for continuous innovation and adoption of available technology in the suitable to the local context.

Innovation Rankings

Innovation Capacity Index Rankings 2010–2011 published by European Business School listed 130 countries. The index was prepared from best available data on policies, institutional characteristics and initiations taken and the result revealed that Sweden is first, Korea is eleventh and Nepal's position is 102nd (China 64 and India 88). The report also claimed that among the various drivers of economic growth and prosperity evolved over time, the innovation is now emerging as a leading factor. Also the report provide comprehensive look on the role of innovation in enhancing innovation process. Moreover, the report identifies over 60 factors that are seen to have a bearing on a country's ability to create an environment that encourages innovation, such as a nation's institutional environment, human capital endowment, the presence of social inclusion, the regulatory and legal framework, the infrastructure for research and development, and the adoption and use of information and communication technologies, among others.

Replicability of Innovation

As we can see in the following figure, the design principles are the components which are replicable, policy tools that some country already used may be partially replicable whereas it is somewhat obvious fact. That the contextual characteristics are totally non-replicable.

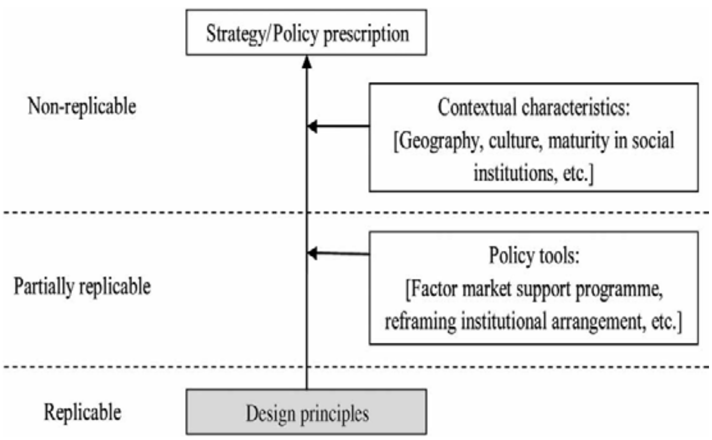

Figure 1: Design principles as replicable lessons (Lee and , pg-101)

Lee and Baek (2012) based their analytical discussions on design principles. It is necessary to identify the design principles before extracting replicable lessons. Identified design principles are : (a) Coherent policy framework (b) Co-evolution of policy structure (c) Strong public-private partnership (d) Adequate implementation capacity.

Innovation is key for development. Every sector needs innovation may that be agriculture, culture, environment, policy formulation, science and technology and others. And for this we first have of identify the design principles and within clear-cut innovation policy and National Innovation System to accomplish the valued functions. This works should be owned not only by government agencies but also by research institutions, independent organizations, universities, private companies and entrepreneurs as well.

Nepalese Context

National innovation system and policy should be based on the homegrown model based on history, approach, style and level of development. External support can be in the field of training and joint research. South Korean expert group has given interest to support Nepal in this regard and already conducted on workshop cum thematic discussion on innovation policy for Nepal in November 2012. Many works has to be done in regular manner in each and every sector of development. Still some benchmarking is needed and learning from abroad as adaptable case studies are nice to have.

In public financial sector of Nepal, real time reporting based on computerized data management and other ways of integrating expenditure are on the way which we call Treasury Single Account (TSA). Still it is not applied in all districts but positive impacts can be seen. The system itself also needs more innovation on itself. And the concerned ministry and coordinating organization should provide encouragement, discussion forum and incentives for evolving ideas on it so that there remain no more loop holes in public funds management.

Conclusion

Innovation as a driver of productivity and economic growth, Twenty first century is the century of knowledge, ideas and innovation. They cannot be functional in the ideal stage rather we should be prepared to adapt and diffuse in right time and right place. It's time to build critical mass of innovators in every sector and move ahead with coordinated effort. National level policy and system can be tool of government intervention but the functional liabilities goes to all concerned. Only need is recognition and encouragement to those who strive for new kind of ideas, technological model and any kind of innovation for the betterment of our society.

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Nepal Public Sector Accounting Standard – Implementation constraints

- Shreekrishna Nepal[6]

Accounting standard:

Accounting standard is generally known as certain accounting rules to be followed for the accounting, recording and presentation of financial statements. Such standard maintains uniformity on general purpose financial report[7] among the entities; furthermore the readers can easily compare same financial statement of different units. It assures the quality of financial statements in terms of completeness, reliability, consistency and so forth.

Free dictionary .com defines Accounting standard "a principle that governs current accounting practice and that is used as a reference to determine the appropriate treatment of complex transactions."

It has been accepted as accounting language across the globe. Financial statement should provide true and fair view, which is possible only after the statement is prepared on the basis of said standard. Accounting standards entail policies, rules, formats, disclosures and explanations. Accounting standard can only ensures the uniformity, reliability, transparency, and consistency of financial statement. Standard ensures relevance, faithful representation, understandability, comparability, timeliness and verifiability of general purpose financial statements (GPFS). GPFS contains quantitative (Financial) as well as qualitative (non-financial) information.

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[6] Mr. Nepal is Chief District Comptroller General Officer in Rupandehi district.

[7] General purpose financial report refers to financial report intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.

Public Sector Accounting Standard[8]:

International Public Sector Accounting Standard Board (IPSASB) has developed International Public Sector Accounting Standards (IPSAS) for public sector entities. It fosters quality and comparability of public sector financial information. IPSAS is intended to enhance the quality and transparency of public sector financial reporting by providing better information for public financial management (PFM) and decision making.

IPSASB has issued IPSAASs dealing with financial reporting under the cash basis[9] and accrual basis[10] of accounting. Accrual IPSASs are in line with International Financial Reporting Standard (IFRS). There are 32 standards for accrual basis and one for cash basis with encouraged additional disclosure (Part two) which is taken as optional part. Part two of Cash Basis IPSAS encourages an entity to voluntarily disclose accrual based information, although its core financial statements will nonetheless be prepared under the cash basis of accounting.

IPSAS makes possible to compare a relevant economic phenomenon by one public sector entity to a similar relevant economic phenomenon by other entity. It would not be possible if there would be alternative accounting method, which would in turn, diminish comparability. Before May 2000, there was no standard in existence for Public sector; only the Generally Accepted Accounting Principle (GAAP) was followed, which is not more than commonly followed accounting rule. IPSASs are living document. IPSASB revises or amends as per necessity.[11]

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[8] The term "public sector" refers to national governments, regional (e.g,state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises

[9] Cash basis means a basis of accounting that recognizes transactions and other events only when cash is received or paid.(IPSAS cash 1.2)

[10] Accrual basis means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate.

[11] For instance :
IPSAS 1, *Presentation of Financial Statements* was issued in May 2000.

Nepal Public Sector Accounting Standard (NPSAS):

Accounting Standard Board (ASB) has developed the NPSAS for Public sector entities in Nepal under the cash basis of accounting in line with IPSAS cash basis. It would be an important step forward in improving consistency and comparability of financial reporting; after the adoption of this standard. It has two parts (requirements and encouragements) and financial statement should be described as complying with NPSAS only if they comply with all the requirements of part one. NPSAS has already got approval from Government of Nepal in September15, 2009. In this way development and adoption of NPSAS has been done, still to implement. Implementation seems challenging to roll over up to all entities preparing general purpose financial statement. It is expected that the NPSAS will enhance comprehensive and transparent financial reporting of cash receipts, cash payments, and cash balances of the entity. There will be the benefit of comparability with the own entity's previous period as well as of other entities adopting same standard.

Part one entails following requirements, all the requirements should be complied at a time according to the 1.1.4 of NPSAS.

1.1 Scope of the requirements

1.2 The Cash basis

1.3 Presentation and disclosure requirements

1.4 General considerations

1.5 Correction of errors

In December 2006 the IPSASB issued a revised IPSAS 1.Since then, IPSAS 1 has been amended by the following IPSASs:

☐*Improvements to IPSASs 2011* (issued October 2011)
☐*Improvements to IPSASs* (issued January 2010)
☐IPSAS 28, *Financial Instruments: Presentation* (issued January 2010)
☐IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
☐IPSAS 30, *Financial Instruments: Disclosures* (issued January 2010)
☐*Improvements to IPSASs* (issued November 2010)

1.6 Consolidated financial statements

1.7 Foreign Currency

1.8 Effective date of 1.1 to 1.7 and transitional provisions

1.9 Presentation of budget information in financial statements

1.10 Receipts of external assistance.

NPSAS implementation plan:

Government of Nepal (GON) has approved NPSAS and decided to implement. Financial Comptroller General Office is responsible for the implementation of NPSAS. GON has signed the agreement with World Bank for Strengthening PFM project funding through multi donor trust fund (MDTF). Component two of the project "strengthening accounting and reporting practices in public and private sector" has included initial activity for implementing NPSAS. The project aims to Pilot NPSAS at one or two ministries for preparation of consolidated financial statements through capacity development program like training and workshops. The piloting is expected to deliver experiences which will be used to explore with relevant stakeholders and to devise a roadmap for the GoN to implement IPSAS based NPSAS across the whole of government.

Implementation Constraints:

Capacity development and provision of infrastructure are crucial for effective implementation of NPSAS. Pilot activity included in PFM strengthening project is yet to materialize. Awareness, consensus among stakeholders and preparedness to move forward are other equally significant aspects for implementation. FCGO should take a lead; address the constraints in time and make an environment for implementing NPSAS. Development of Standard, adaptation and implementation is a common cycle for systematic application of accounting standard. Previous two steps have already been done and now the momentum looks slow, that is why vital step implementation is still uncertain.

1. Formulation of accounting policy in general and specific accounting policies for revenue, deposit, special funds, and financing etc. should be completed based on the entire practice in line with standards. It is a complex task. Not easy to capture all the transaction practices in policy, might vary within sectors. We should provide room for accounting practitioners, national experts as well as chartered accountants in this job. Realistic, consistent and credible accounting policy includes principles, bases, conventions rules and practices adopted by an entity. Preparation and presentation of financial statement, complying the respective policy is the fundamental step for adaptation of the standard. We have not only Capacity constraints for the formulation of accounting policies but also addressing exactly the principle, rules and practices.

2. Defining general purpose financial statements as well as the entities entitled to issue those statements is another step for the implementation of standard. Whether it should be issued by the economic entity or responsibility should expand up to the controlling entity or by all controlled entities. There is a skill deficit at the controlled entity level. Information regarding the external assistance, third party payments, and exchange rate adjustment would only be available at ministry / department level. So the availability of complete information for preparing cash and comparison of budget statement at district level entity is another challenge.

3. Preparation of cash flow statement by capturing all the cash and cash equivalents is another challenge. Current practice is recording receipt and payments on bank cash book. Statement of cash receipt and payment as per 1.3.4(a) of NPSAS is comprehensive and amounts of the cash receipt and payment as per 1.3.12 of NPSAS should be brought from various accounts. Designing the accounting system for channelizing these information is a huge task.

4 . Consolidated statement's scope and consolidation at FCGO: According to the 1.6.1 of NPSAS economic entity is responsible for preparing consolidated statement as that of a single entity. If we define ministries as the economic entity; they should get complete and standard base reports from the departments and every entity should report towards department accordingly. This flow of reporting has been weakened due to the incompleteness and inaccuracy. Paying offices have depended up on

DTCO's database and departments and ministries with FMIS at FCGO. So this is the area to be improved for effective implementation of NPSAS.

4. Elimination of duplications: Duplication of fund flow transactions between entities should be eliminated while calculating cash receipts, payments and cash balance. It cannot be calculated unless or until we design the reporting system.

Implementation options:

At first; it would be better to implement NPSAS at FCGO in consolidated central reporting only. Next step is to implement up to ministry level in general purpose financial statement and consolidation at FCGO in central reporting. Then after; it would be feasible to implement across the nation at entity level. We also have an option to establish automated system within entire TSA/FMIS for NPSAS friendly reporting. It would only cover the information for the face of the reporting, notes and disclosures should be added manually. We have to develop cadres for NPSAS within account group through various capacity development programs.

Currently, we do not have option for implementing NPSAS cash basis. GPFS should be produced in line with NPSAS for reliability and consistency of the public sector reporting. Implementation of part two of the NPSAS cash and aggregation of the information for additional disclosure should also be in priority for moving forward and implementation of accrual basis IPSAS. We, accounting professional have vital role in implementation process. Developing roadmap, action plan, institutional activism, capacity development and specially designing functional channel for bottom up reporting are some areas immediately to be addressed for the assurance of smooth implementation.

Reference:

1. Nepal Public Sector Accounting Standard, Accounting Standard Board 2009.

2. Handbook of International Public Sector Accounting Pronouncements (Volume 1-2) 2013.

3. Related websites.

Local level Public Financial Management reform initiatives

- Babu Ram Shrestha

Background

Public Financial Management (PFM) in the narrowest, and perhaps most traditional, sense is concerned with how government manage the budget in its established phases-formulation, approval and execution. It deals with the set of process and procedures that covers all aspects of expenditure management in government. The simple passage from *expenditure* to *financial* management has broadened its focus from the narrowly defined budget to all aspects of managing public resources, including resource mobilization and debt management, with a progressive extension to the medium to long term implications and risks to public finances from today's policy decisions.

PFM is now "umbrella" definition covering a set of systems aimed at producing information, process and rules that can help support fiscal policymaking as well as provide instruments for an implementation.

The key objective of public financial management - maintaining a sustainable fiscal position, the effective allocation of resources, and the efficient delivery of public goods and service- have long been established in the literature.[12]

Nepal’s PFM at the national level

Nepal’s weak governance ratings are reflected in the results of the Public Expenditure and Financial Accountability (PEFA) assessment in 2008, which found significant gaps in its PFM system. Of 31 indicators, only 1 scored an A (in budget credibility) and only 3 scored a B (one in budget credibility and two in budget comprehensiveness and

[12] Since the early 1990s, these objectives have been the standard PFM objectives used in academia and by the IMF and World Bank and other international financial institutions.

transparency). The rest were rated C (8 indicators), C+ (9 indicators), D+ (7 indicators), and D (3 indicators).[13]

Although some budget and fiscal management indicators scored relatively well, the assessment points to major weaknesses in budget classification, transparency of inter-governmental fiscal relations, oversight of fiscal risks of public sector entities, and extent of unreported government operations. The PEFA findings were echoed in the country Fiduciary Risk Assessment conducted by DFID in 2008,[14] leading the government itself to describe Nepal as a "high fiduciary risk environment".[15]

Nepal's PFM at the sub-national level

A PEFA assessment at the sub-national level conducted in 2009 indicated that PFM deficiencies at the national level cascade to the local level. Although the sample of this sub-national PEFA study was neither comprehensive nor representative[16], the findings raised serious concerns. No local body scored an A, 33% were rated B, 50% were assessed as C, and 17% as D. The bases for these low ratings were numerous, including ineffective internal audits, overpayment, payment without adequate supporting documents, administrative expenses above limits, weakness in procurement and assets/inventory management, and expenditures without proper approval.

The need for local capacity development is crucial in the context of speeding progress toward the achievement of the local level development objectives. The greater the stakeholders are competent of formulating, implementing and monitoring suitable policies, plans and programs, the more the chances of attaining development objectives either at the central or local level. When stakeholders and practitioners at local level can independently handle planning and implementation tasks, both the efficiency and effectiveness of development efforts could be enhanced.

[13] *Nepal PEFA: An Assessment of the Public Financial Management Performance Measurement Framework (as of FY 2005/06).* February 2006, Government of Nepal. The PEFA ratings for its indicators seek to compare a country to international best practice, with the score ranging from A (highest) to D (lowest).
[14] *Fiduciary Risk Assessment: Nepal*. 2008. U.K. Department for International Development.
[15] *Public Financial Management Reform Program (PFMRP), Phase 1 (2009/10 – 20011/12)*, PEFA Steering Committee, Government of Nepal, May 2011, p.2.
[16] The sample consisted of 5 districts (out of 75), 10 VDCs (out of 3915), and 3 municipalities (out of 58).

The Local Self-Governance Act (LSGA) has granted VDCs, municipalities, and district development committees (DDCs) higher political, administrative, and financial powers to lead, facilitate, and manage local affairs. As stated by Bhatta (2011) LSGA adheres to the district as a primary unit of local government. But the various districts, which differ widely in size, are not designed as economic units or to provide services to citizens efficiently and effectively; they were set up more for law and order and administration[17].

It is crucial to explore if the development fund is allocated in the right sectors, if it fits in with other resources, and if it is hitting the areas that have most need. There are certain areas where local government body needs to improve, especially to learn if fund is mobilized where it is meant to, and what has been its implication and impact for the community. Ministry of Federal Affairs and Local Development can take steps to improve the quality and timeliness of the reports on fair and sustainable fund management system**.**

Budget and fiscal management issues at the local level.

The weaknesses of sub-national PFM systems are evident in local budget and fiscal management. Without elected representatives, local councils are non-existent, and budget preparation lacks public participation. Internal audits at the local level are problematic, with unskilled and limited staff and no appropriate system (no internal audit guidelines, planning and scheduling), plus poor reporting of results and monitoring of audit findings. The budget's capital component comes from central transfers, which have been unpredictable, resulting in delays in completing projects. Costing of capital expenditure and provision for asset maintenance **ar**inadequate, compounded by lack of output and outcome orientation to budgets. Costing of services is not carried out, resulting in poor cost recovery including in the sectors of education and health that account for a majority of local public spending. There is no budget manual to guide the budgeting process. Revenue and expenditure forecasting is

[17]Fiscal Decentralization and Fiduciary Risks: A Case Study of Local Governance in Nepal, GambhirBhatta No. 5 June 2011, ADB South Asia Working Paper Series

rudimentary. For municipalities, which have the most scope for fiscal autonomy, actual revenue collected is much less than potential revenue due to lack of property records; tax rates have not been revised since 1999; and houses do not even have addresses.

Ongoing Reforms and New Areas

The new PFM and Fiduciary Risk Reduction Action Plan (FRRAP)

Ministry of Federal Affairs and Local Development (MOFALD) in March 2012 approved a Fiduciary Risk Reduction Action Plan (FRRAP). The plan reflects lessons learned from Local Governance and Community Development ProgrammeLGCDP Phase I implementation, notably importance of strengthening PFM systems and capacity building in PFM at the local level, and the value of demand-side mechanisms. No less important, the Plan fills the "subnational gap" in PFM reforms, because the Multi-Donor Trust Fund (MDTF) and others are focused on key national PFM reforms.

Local Governance and Community Development Program (LGCDP) - II

Local Governance and Community Development Programme (LGCDP), Phase II Joint Financing Agreement (JFA) has been signed. Which has clearly defined the following Goal, Outcomes, Outputs and Major Activities

Goal

The overall goal of the programme is ***to contribute towards poverty reduction through better local governance***.

The goal of the programme is aligned with national goals of the GoN's three year interim development plan and will contribute either directly or indirectly by empowering citizens and responding to their priorities needs while at the same time strengthening decentralized local governance systems and integrated service delivery.

Purpose

The purpose of the programme is ***to improve local governance for effective service delivery and citizen empowerment.***

LGCDP II provides an overall framework for: strengthening decentralization, devolution and improved local governance system for effective delivery of basic services and empowerment of citizens, especially women, children and Disadvantaged groups (DAGs) and their institutions. It has been designed as a framework program with **four outcome** and **nine output** areas.

Outcomes, outputs and activities:

The four outcomes encompass **citizen's empowerment** (demand side improvements)**, capacity development** (supply side improvements), **enhanced service delivery, integrated planning process,** and, **citizen-centric policy development.**

Outcome 1: Citizens and communities, actively engaged with local governments and holding them accountable

During the first phase of LGCDP, a strong institutional base and capacity was created through social mobilization and capacity development initiatives. In this second phase, the focus of the programme will lie on: producing results through empowered citizens, especially women, children and DAGs and their institutions; engaging the citizens in local level planning, monitoring and oversight process to make local governance actors accountable; and, having deeper and effective social mobilization.

Under this outcome two demand side outputs will be achieved.

Output 1: Citizens' Participation: Citizens and community organizations actively participate in local governance.

This output is focused on empowerment of citizens, especially women, children and disadvantaged groups, and their institutions (CACs, WCFs, IPFCs, DSMC/MSMCs, and CFLGCs) so that they may meaningfully participate in local planning, budgeting and monitoring and decision making processes.

Output 2: Public Accountability: Citizens and communities empowered to assert their rights and hold government accountable at the local level.

Socially mobilized groups and institutions will also be engaged in oversight activities to hold the local governance actors responsive and accountable to citizens and their institutions.

Outcome 2: Increased access to resources and improved financial and management capacity of local governance actors

Under this outcome the LGCDP will support efforts to expand the availability of flexible funds based on predictable and formula-based budgetary transfers through the well-established Minimum Conditions and Performance Measures (MC/PM) system which was initiated during LGCDP I. The continued provision of performance-based funds and capacity support to under-performing local governments will continue to be a part of the LGCDP design.

The outputs expected to be delivered for the pursuit of this outcome are:

Output 3: LB's access to resources increased

This output seeks to ensure that LBs' secure adequate finances to provide mandated services and meet the priority service needs of citizens. This output will focus on maximizing grants and transfers from the central government to the local bodies. Optimization of own-source revenue is also a focus of this output.

Output 4: Public financial management system improved

This output encompasses all of the LGCDP's Phase II efforts to strengthen the capacities of the MOFALD, local bodies and other local governance actors in financial management.

Output 5: Institutional and human resource capacities strengthened

This output has to do with strengthening the institutional capacities and man resource capabilities of MOFALD, local bodies and other local governance actors. This could include actions aimed at implementing organizational, procedural and process reforms.

Outcome 3: **Improved efficiency and effectiveness of local service delivery**

Two outputs are proposed for achieving this outcome:

Output 6: Service delivery and local infrastructure improved

Output 7: Strengthened integrated planning, budgeting and coordination amongst local governance actors

Outcome 4: Strengthened policy and institutional framework for devolution and local self-governance

LGCDP II will support government policy work aimed at clarifying local government expenditures which will need to be undertaken in support of Nepal's move to a federal system of government. Intergovernmental expenditure assignments between national and local/federal government will be clarified. Fiscal decentralization study recommendations from LGCDP I will be implemented to ensure that local governments receive formula-based, predictable and timely financial resources from the national government to fund improved service delivery.

The outputs to be undertaken to achieve this outcome are:

Output 8: Refined policy on local governance and improved inter-agency cooperation

Output 9: Policies developed for devolution and federalism

Strengthening Public Management Program (SPMP)

Strengthening Public Management Project (administered by the ADB) agreement has been signed and is ready to take of now. The Program outputs, which are (i) improved local budget and fiscal management, (ii) strengthened sub-national fiduciary risk management, (iii) enhanced public procurement system, and (iv) strengthened institutions of oversight and accountability, will be achieved through complementary components as described below.

Component 1: Local budget and fiscal management.
Component 2: Sub-national fiduciary risk management.
Component 3: Public procurement reform.
Component 4: Oversight and accountability capacity-building.

Computerization of the Village Development Committees (VDC) accounting software is continuing. This reform is initiating by Financial Administration Section of the Ministry. District Development Committees (DDC) has been directed to coordinate the activity with training support through the MOFALD. Most of the VDC's are small in budgetary volume and lack basic infrastructure and manpower. In the initial phase only the equipped VDCs are trained.

Accrual Accounting System (AAS) has been piloting in six Municipalities as Kirtipur, Pokhara, Lekhnath, Butwal, Dharanand Mechinaga municipalities. After the successful completion of the piloting in the six municipalities Accrual Accounting System (AAS) will be rolled out in the remaining municipalities.

District Development Committee Financial and Management Program (DDCFAMP) has been updated in new version and oriented to all the DDC accounts personnel and computer operators. Training to run the Accounting Software are some challenges ahead and the ministry is trying to cope these challenges through SPMP in the framework of LGCDP II. The software is designed using oracle database and in future it can be linked with Central level accounting software. Ministry is now planning towards developing ministry level accounting software through appropriate consulting service and establishment of proper linkage between DDCFAMP and central level software so that data and information can be directly transmitted via electronic media.

Agreed Actions under the Nepal Portfolio Performance Review (NPPR) Action Plan 2012

Ministry of Federal Affairs and Local Development had agreed on the following actions under the Nepal Portfolio Performance Review (NPPR) Action Plan 2012 in the local PFM reform initiations

1. Develop sample PEFA/FRRAP for Local bodies.
2. Localize PEFA/FRRAP in 10 DDC, all Sub-Metropolitan & Metropolitan cities
3. Orientation on PEFA/FRRAP to local bodies staff in five region.
4. Develop capacity development plan of local bodies with outcome Indicators.
5. DDC FAMP orientations in new coding system (GFS) in 75 districts
6. Accrual accounting system will be implemented in six Municipalities.
7. 1000 VDC secretaries will be trained in VDC accounting software.

Problem Areas that Need Further Attention:

The above described issues are some of the main issues only; although the cross-cutting tasks for each activity has been included as Capacity Development (CD), Gender Equity and Social Inclusion (GESI);Child Friendly Local Governance (CFLG);Environment Friendly Local Governance (Environmental Safeguards, Climate Change Mitigation and Disaster Risk Management (ES-CCM-DRM);Results-Based Management in the Annual Implementation Plan and a separate annual plan developed for each cross cutting theme, still there are more cross-cutting issues that need to be attended to. The sequencing of reforms need to be done, in order to institutionalize the basic reforms first; instead of going all out for all reforms at the same time. The simple systems may be tried first and internalize the skills and spirit of reforms. The recognition of the need for reforms and efforts of the government so far, need to be institutionalized and monitored regularly.

Reference:

Public Financial Management and its Emerging Architecture/editors, Marco Cangiano, Teresa Curristine, and Michel Lazare- Washington,DC: International Monetory Fund,@2013

Fiscal Decentralization and Fiduciary Risks: A Case Study of Local Governance in Nepal, GambhirBhatta, No. 5 June 2011, ADB South Asia Working Paper Series

Nepal PEFA: An Assessment of the Public Financial Management Performance Measurement Framework (as of FY 2005/06). February 2006, Government of Nepal

Realistic Budgeting for capital Expenditure: Suggested Draft Mechanism of Segregation of Budget into Approved Budget Projects and Projects Carried Forward/or in Pipeline

- Udaya Pant[18]

The Government of Nepal (GON) has been implementing its Public Financial Management Reform Program (PFMRP) with the assistance of development partners.[19] The PFMRP was developed as a sequel of the recommendations on the gap areas in the PFM systems in Nepal by the PEFA Assessment 2007 (based on 2005-06 data and report published in 2008). The areas included in the PFMRP-Phase I[20] are: (1) enhancing the policy content of the budget; (2) strengthening budget execution by improved controls, procurement, and debt and cash management; (3) improving accounting and reporting; and (4) strengthening external audit. Recently, development partners agreed to support the GON implement a project called Strengthening PFM Systems through the Multi-Donor Trust Fund led by the World Bank. There are three components of the project: implementation of the Treasury Single Account (TSA) System, strengthening accounting and reporting practices in public and private sectors, and supporting the capacity-building of the Public Expenditure and Financial Accountability (PEFA) Secretariat.[21]

Budget execution and performance budgeting has been a key weakness in Nepal; with the delays in implementation of capital projects and slow pace of capital expenditure.

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[18] Udaya Pant is an internationally acclaimed PFM expert, currently IMF's PFM Advisor in Nepal. The expressed are personal to him.

[19] These include the IMF, World Bank (WB), the Asian Development Bank (ADB), the UK Department of Finance and International Development (DFID), GIZ of Germany, AUSAID of Australia, Embassy of Denmark, Embassy of Norway, Canadian International Development Agency (CIDA), UN, USAID. The Fiscal Affairs Department (FAD) of the IMF has been providing technical assistance on PFM through its resident PFM advisor, short-term expert visit, and IMF Headquarter (HQ) missions.

[20] PFMRP Phase I (2009), MOF, Nepal

[21] The PEFA Secretariat is organized to coordinate, monitor and facilitate PFM/PEFA implementation in Nepal.

Although, the trends of performance of capital expenditure are improved, there are problems and gaps in the budgets provided for the projects that are not ready to take off.

The Problem:

Under-spending of the capital budget has several reasons; some of them are allocations made for the new or half-baked proposals, non- receipt of committed funds through the donors, derailed project reports (DPR) and procurement plans not being ready, missing approval by the authorities like National Planning Commission, local bodies, environment clearances, legal matters pending and so on. This not only slows down the pace of capital expenditure but makes it a bad-budgeting; and poor budget linked performance.

Budget-linked performance targets approach to performance budgeting involves setting performance targets for all line ministries as part of the budget process. The most successful example of this approach is the U.K.“Public Service Agreement”system[22].

It requires[23]

- a well-developed performance measurement system; and
- a solid information base on the relationship between funding levels and the results which

- The ministry can be expected to achieve.

Background and Objective

In Nepal, MOF has been providing the Budget allocations for the projects of different line ministries, even for partially funded projects, where funding by the Donor(s) is still under process. However, until the donor funds arrive, expenditure even the counterpart funds or the procurement process doesn’t start, in the existing system. Sometimes,

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[22] P. Smith,“Performance Budgeting in England: Public Service Agreements,”(in Performance Budgeting), edited by

[23] Marc Robinson in 2007 and Duncan Last (2009), A Basic Model of Performance-Based Budgeting, IMF, Fiscal Affairs Department

projects in the pipeline for sanction and approval also get excluded in the budgetary allocations.

If a project is approved in the Budget process and there are no donor funds available for such projects, during the year, there may be possibility of finding donors or use the GON funds to finance them. In the present system that type of flexibility does not exist. There has been criticism from the donors and the international organizations about unrealistic budgeting and low levels of spending in the capital projects. It is observed that one of the main reasons for the low spending levels is the Line Ministries blocking the funds under projects that do not take off during the particular fiscal year. As a result, additional funds could not be allocated to those ministries which can spend them meaningfully during the year. It is also true that if the funds are available and projects do not spend the allocated funds, we lose both in terms of time and cost consideration for not spending the funds.

The present system does not allow the efficient ministries or programs to get the benefit of utilizing the unspent funds blocked by others; though they may have an absorptive capacity and genuine development needs to spend more funds. There is no in-year competition element among the ministries and sectors for expenditure efficiency and resultant productivity.

It may be worthwhile to consider that in the coming year onwards GON may distinguish between Approved Budget (ongoing and new approved projects that are ready to take off) and the Projects for which approval by NPC and Donors are anticipated during the year and procurement plans are likely to be in place. The objective for this is to facilitate approval of spending for such projects upfront, which are maturing for implementation; and provide only seed money or 'token provision' for projects not approved by NPC and donors for procurement and takeoff in the next few months.

Problems and Threats

- One of the reasons of reporting of slow progress of projects implementation and low capital expenditure can also be attributed to not segregating the projects that are approved and ready with implementation plans; and the projects that have not matured for implementation.

- This results in the problem of Line Ministries etc. submitting their 'wish lists' in the budget submissions and also results in exhibiting the distorted picture of expenditure trends, by showing the overall lower utilization of funds.
- Another problem that may also arise is projects that are likely to be approved shortly and can be implemented in the coming months, get excluded in the Budget Plan of the ministries.
- The present system does not allow more efficient and ministries with better appetite for development spending, to compete for higher allocations from out of the Sector outlays, for new developmental projects.

Possible Solution

The objective here conceptually means that we provide a window for the Projects that may be in the pipeline for approval or will be ready for execution (or may not actually be approved sometimes) in future. The budget allocation henceforth may be segregated for the ongoing projects under implementation; and the projects that are carried forward (for non-implementation) and those in the pipeline for approvals of funding or not ready with procurement plans. The requirement for the National Planning Commission (NPC) to assess high priority projects after budget approval could be eliminated. Instead, information regarding performance benchmarks (currently addressed through the NPC's post-budget approval assessment) would be included in budget submissions and endorsed by NPC prior to formal budget approval.[24]

Consider the following system

- **Provide for indicative budget for allocation of funds in these projects in the pipeline, in the MOF's contingent budget for ministries within the agreed**

[24] Nepal 2012 Article IV country Report, IMF Country Report No.12/326

ceilings; and allow budget allotment only when projects are approved and ready for implementation.

- Some seed-money (token provision) can be provided from the Ministry of Finance to fund any feasibility study, project design and other contingent requirement to fund development projects' start up work related expenditure.
- MOF will not provide funds out of this; except for the specified projects or funding the **preparations of detailed project reports**.
- In the Line Ministries, the **Budget Ceiling will cater to all Projects (approved budget and carry forward/pipeline projects**). **However, unspent funds approved for carried forward projects in the previous year can be added to the ceiling of next year.**
- The projects in pipeline will be included in their Budget plan as projects approved by the NPC and the Legislature. **On approval by the NPC and the readiness of procurement plans etc. they will be upgraded to the Approved Project category.**
- **It will be possible to give higher or lower allocation for the ministries within the Sector, if they have higher rate of utilization of funds during the year. This can be done with the approval of Budget Division on recommendation of the NPC.**
- Donors may also be encouraged to allow ministries to transfer funds earmarked for one project to other for the projects funded by the same donor during the course of the year. The actual utilization of funds will be adjusted in the respective project grant/account.

Criteria for Moving from Approved Project to Approved Budget

- The actual allotment for these projects will be made available only on readiness of implementation and procurement plans.

- Projects waiting for funding for the two successive years will be deleted from the list of Approved Projects in the third year.
- Unfunded projects will have to await the funding approvals that may come during the Year.
- On Funds availability and readiness of procurement plans they will get allotments from the Budget department, as usual
- For presentation purposes they will be added to Approved Budget in the Mid Year Review

Criteria for Moving funds from Approved Projects of One Ministry to Other Ministries' Approved Budget

- Funds transfer can be only within the Sector
- It will be allowed only for projects that are
    - viable and revenue generating
    - economy, efficiency and productivity compliant
    - labor intensive
    - passing the test on quantified and measurable outputs and outcomes
    - qualify on the Plan priorities
    - not focusing on procuring the luxurious items purchases like vehicles, foreign travels, or meeting mostly operating expenses
- The inter-ministry transfer will be decided by a Budget Committee under Finance Secretary
- Budget Committee will meet once a month, or need based, from the second quarter onwards

- Budget Committee will have some discretion to transfer funds from one Sector to another, on specific and justified requests. (for example, MOPH has only one Ministry in the Sector- in case they have substantial projected savings, Budget Committee will allow transfer to other Sectors but restore the funds next year to the MOPH)
- Funds transferred from one ministry or Sector to another will be adjusted and restored in the next year's ceilings
- For projects specific donor funds (non-discretionary funds) approval of the donor will be required.
- The system will have active linkages with the MTBF and MTEF.

Advantages

1. Projects approved in principle by NPC and legislature upfront
2. Projects that are mature to take off can start immediately on funds approval
3. Ministry of Finance will have a window (within contingent money put under MoF) to finance feasibility study, project preparation and design; and will allocate out of this for new projects proposal preparation
4. Procurement plans and start up activity can start in advance
5. Unfunded projects may find a donor during the year and projects can be implemented
6. In case the projects do not take off during the year, it can be explained in the expenditure trends during the year (and will show the realistic expenditure trend); as the project will not get allotment until there is a genuine demand for that.
7. More new projects can be included by Line Ministries, based on their realistic projections for budgetary requirement during the year and subsequent two years; and prioritization can change during the year for allotment of funds

8. Small donors can provide discretionary funds under this arrangement, in future. That will facilitate funding for national priorities by the Government.

9. Expenditure and projects implementation monitoring will be more realistic.

Issues

- Allocation will be based on the pace of implementation
- MOF and LM will have to ensure the internal control arrangements
- Project Managers and LM's have to be held Accountable for any deviations or unauthorized spending (Internal Audit/Audit should facilitate this)
- Monitor Projects and donor funds approval
- Midyear review stage - revise corresponding ceiling of the LM for Approved Projects to the extent of funds requirement
- Adjustments (within the sectors or beyond) if any required, for funds released will be done while MYR
- Start up Plan and Procurement Plans can begin (EOI for ICB or National shopping) but procurement contracts will await approval
- Involvement of focal points in NPC, Budget and LM's Managers will be crucial
- Projects planning and design, implementation roadmaps; and results framework should be improved

This system works well in Afghanistan (developed by the Author and introduced in 2005-06) and has been adapted by other developing countries like Liberia etc. Neighboring countries also follow similar system where token provisions only are allocated for the projects not ready to take off and additional allocations are provided by Supplementary or the virement process.

International Public Sector Accounting Standards (IPSAS) & Nepal Public Sector Accounting Standards (NPSAS)

Kaushlendra Jha[25]

What is IPSAS?

IPSAS refers to International Public Sector Accounting Standards which are a set of accounting standards issued by the IPSAS Board for use by public sector entities around the world in the preparation of financial statements. These standards are based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The difference between the two IFRS and IPSAS is that IFRS is being adopted by corporate entities around the world either directly or through national standards convergent with IFRS whereas IPSAS are accounting standards for application by national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards and commissions). IPSAS standards are widely used by intergovernmental organizations. IPSAS do not apply to government business enterprises.

Need of IPSAS and Its emergence?

In the change of corporate world globalization has taken place where no any closed economy can function and grow surrounding by globalizing environments. Now any country/economy wants to grow cannot grow independently and consequently cross border transactions and investments have grown vastly.

Every country having its own accounting principles and presentation of financial statements which results into difficulties of comparison of cross boarder results of the companies.

[25] Kaushlendra Jha, is a practicing Chartered Accountant and Director, JKK Consulting Pvt Ltd, India & Nepal

To eliminate the difficulties and reaching to same set of reporting standards i.e. global financial reporting language, IFRS (International Financial Reporting Standards) emerged sourced from IAS (International Accounting Standards) issued by the International Accounting Standards Board (IASB).

By far success of IFRS is concerned; it's getting much acceptance worldwide among stakeholders which are for corporate sectors solely.

But need of IPSAS emerges to improve the quality of general purpose financial reporting by public sector entities, leading to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability.

Now public sectors entities and one particulars governments have not remained isolated because of Bilateral, Plulaterals and Multilaterals relations among states and involvement of Multilaterals agencies like ADB,EU, IMF,UN, UNDP and world Bank etc in development of developing and under developing states.

Issuance of IPSAS and its observers

IPSAS are issued by IPSASB (International Public Sector Accounting Standards Board), an independent organ of IFAC (International Federation of Accountants). The IPSASB adopts a due process for the development of IPSAS that provides the opportunity for comment by interested parties including auditors, preparers (including finance ministries), standard setters, and individuals. Observers on the IPSASB meetings include ADB, EU, IASB, IMF, INTOSAI, OECD, UN, UNDP and the World Bank.

Convergence of IPSAS with IFRS

IPSAS are based on the International Financial Reporting Standards (IFRS), formerly known as IAS. IFRS are issued by the International Accounting Standards Board (IASB). **IPSASB adapts IFRS to a public sector context when appropriate**. In undertaking that process, the IPSASB attempts, wherever possible, to maintain the accounting treatment and original text of the IFRS unless there is a significant public sector issue which warrants a departure.

Till date there are **32 standards** on IPSAS out of which **31 standards** are on the accrual basis of accounting one **standard** is on the cash basis of accounting

Funding for adoption of IPSASs for developing and least developing country

Multilateral development banks (World Bank, ADB) provide a substantial amount of funding for the work of IPSASB. Other sources of revenue for the development of IPSASs include funding from international, national and regional government entities. In addition, IFAC (International Federation of Accountants) and the CICA (Canadian Institute of Chartered Accountants) support the IPSASB activity.

The impact of the credit crisis on public sector accounting

The credit crisis situations experienced have raised several public sector accounting issues around the World. Governments have extended credit to banks, guaranteed the liabilities of banks, purchased impaired debt instruments and in some instances have assumed control of banks. The unique nature of the credit crisis and the unprecedented response by governments around the world has reinforced the importance of high-quality standards for financial reporting by governments. The credit crisis has increased the need for accountability in the public sector and for transparency in its financial dealings.

IPSAS Adoption by intergovernmental organizations

The following intergovernmental organizations have adopted IPSAS or are in the process of adopting IPSAS:

Commonwealth Secretariat; CoE (Council of Europe); EC (European Communities); ESA (European Space Agency); EUMETSAT (European Organisation for the Exploitation of Meteorological Satellites): Aims to be in March 2013. INTERPOL (International Criminal Police Organization); NATO (North Atlantic Treaty

Organization); OECD (Organisation for Economic Cooperation and Development): Issues IPSAS-compliant financial statements since 2000, the first body in the world to do so.

United Nations System

UN (United Nations), Programmes and Funds (such as UNDP, UNICEF and UNHCR), Specialized Agencies (such as FAO, ICAO, ILO, UNIDO, UNESCO, UNOPS and WHO) and Related Organizations (such as IAEA, OPCW, the World Trade Organization, and the World Meteorological Organization) aim to be IPSAS compliant. Whereas **WFP (World Food Programme)**: WFP is the first United Nations agency to implement IPSAS. In its 2008 financial statements, WFP adopted all standards issued by the IPSAS Board including several standards prior to their effective date.

IPSAS Adoption by Country

Many governments say they are introducing IPSAS because it is considered to be good practice. However, very few governments have actually adopted the standards. In terms of the Cash Basis IPSAS not a single country in the world has actually adopted the standard. The main problem is the key requirement to produce consolidated financial statements for all controlled entities. Historically, consolidating government business entities with ministries and departments would be very time consuming and almost all governments consider that it is not worth the very real costs.

Adoption of IPSAS by NEPAL called NPSAS (Nepal Public Sectors Accounting Standards)

The current status of NPSAS implementation is as follows:

The ASB has developed Nepal Public Sector Accounting Standards (NPSAS) for financial reporting under cash basis of accounting in line with the International Public Sector Accounting Standards (IPSAS). The Government agreed to adopt NPSAS on 2009/09/16. However, necessary policy and guidelines for adoption are still in process.

A pilot implementation is ongoing by the FCGO in two ministries, i.e., Ministry of Physical Planning; and Ministry of Women and Child Development. Based on the results of the pilots, NPSAS will be implemented in all ministries/departments of Nepal.

Why it is necessary to adopt IPSASs by NEPAL?

Even if the IFRS has not adopted by Nepal Corporate sectors but the importance and emergence of IPSAS cannot be undermined.

Nepal is the state of which budget structures occupies 26 % through foreign grants and Loan i.e. Nrs. 99.8 Billion Sourced to allocation of its whole budgets. The grant and loan are sourced from all bilateral/multilateral agencies and countries where and allocation and effective utilizations are required to be presented to all stakeholders in returns.

A more comprehensive plan is required for Nepal to adopt Cash Basis IPSAS as part of a longer-term program to adopt accrual-based reporting of expenditures for each government entity.

Previous timelines failed to adopt Cash Basis IPSAS and still in discussion of new timelines and development. The Government of Nepal accounts have been maintained on a cash basis of accounting since 1962 but not in line with Cash Basis IPSAS. The accounts of the local autonomous bodies, Village Development Committees and District Development Committees, are maintained on the cash basis of accounting while the municipalities can maintain accounts either on the cash basis or accrual basis of accounting. The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSAS. All government departments should eventually use Cash Basis IPSAS in preparing financial statements, and then gradually move toward accrual-based IPSAS. The revenue is to be accounted on the cash basis of accounting.

Need to have firm plan, new timelines with policy and guidelines to adopt IPSASs

Even if the government has not come up with definite policy and guidelines to adopt NPSASs which is based on cash basis of accounting and roadmap towards accrual basis of accounting to come up for another IPSASs . As part of progressive plan to enhance the public sector accounting system in compliance with IPSAS, the finance legislation may be amended to make mandatory requirements for the general budget sector to maintain accounts and prepare a consolidated financial statement as guided by IPSAS. With regard to state-owned enterprises (SOE), the Auditor General has already issued directives to these entities to adopt the guidelines stated in the Company Act for presentation of financial statements. The Company Act specifies the Nepal Accounting Standards (NAS), but other applicable International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) are not specified. Even if the IFRS have not been implemented and converged for industry/corporate sectors, Adoption of IPSASs may not be differed long if the confidence of multilateral and bilateral agency if required to keep intact.

The Government may empower the Accounting Standards Board to set IPSAS-based public sector accounting standards.

It is believed that the Government of Nepal may empower the Accounting Standards Board through legal amendment or through appropriate decision, as required, to take a lead to introduce public sector accounting standards based on IPSAS. Currently, ICAN focus on raising awareness of IPSAS´s, the impact of their use around the world and the progress that has been made particularly in the Africa region, subsequent to their adoption, reflects the possible benefits of their adoption and the implementation.

To facilitate the smooth functioning of the Board, to provide necessary resources and communicate the accounting requirement of the Government, a Steering Committee may be formed, chaired by the Finance Secretary and represented by the Financial Comptroller General Office (FCGO), Office of the Auditor General (OAG), ICAN and two standard setting Boards (Accounting and Auditing). The Auditor General may issue directives to state-owned enterprises specifying to adopt applicable IAS and IFRS, and relevant laws governing state-owned enterprises should be amended for adoption of these accounting standards. The Nepal Accounting Standards Board may prepare National Public Sector Accounting Standards on the basis of IPSAS.

An audit opinion needs to be provided on the consolidated government financial statement.

The consolidated financial statements of the Government of Nepal need to be improved by providing a separate audit opinion. While implementing the Cash Basis IPSAS, it is recommended that a separate audit opinion is also provided to the consolidated government financial statements.

IPSAS are based on the International Financial Reporting Standards (IFRS), formerly known as IAS. IFRS are issued by the International Accounting Standards Board (IASB). **IPSASB adapts IFRS to a public sector context when appropriate**. In undertaking that process, the IPSASB attempts, wherever possible, to maintain the accounting treatment and original text of the IFRS unless there is a significant public sector issue which warrants a departure.

Over hundreds country in the world are in process of adoption of IPSASs out of which about **35 countries** have adopted accrual basis of IPSASs are New Zealand, Australia, USA, UK Canada, Colombia, France, South Africa, Switzerland, Russia, Israel, Slovakia, Austria, Brazil, Japan out of which some adopts directly or some adopts through national standards like south Africa, Brazil through national standards.

Some of the developing countries too are front runners in adoption process of IPSASs either in Cash Basis or accrual basis subsequent to cash Basis adoption are:

Albania ,Algeria ,Argentina ,Armenia ,Bangladesh ,Barbados ,Bhutan ,Cambodia ,Cayman Islands ,Chile ,Cyprus ,Colombia ,Costa Rica, East Timor, El Salvador, Estonia, Fiji, Gambia, Guatemala, Honduras Hungary ,India Indonesia, Italy ,Jamaica, Kyrgyzstan, Kuwait, Lao PDR ,Latvia ,Lebanon ,Lesotho ,Malaysia ,Malawi ,Maldives ,Mauritania Mauritius ,Moldova ,Montenegro ,Morocco ,Mozambique ,Namibia ,Nicaragua ,Nigeria, Norway ,Pakistan ,Palestinian Authority ,Peru ,Philippines ,Romania ,Russia ,Rwanda Saudi Arabia, Serbia, Slovenia, Solomon Islands, Sri Lanka, Tajikistan, Tanzania Turkey, Turkmenistan ,Uganda ,Ukraine , Uruguay ,Vanuatu ,Vietnam Yemen, Zambia, Zimbabwe many more:

Whether Nepal can successfully adopt IPSAS

There is general consensus among policy makers, accounting professionals, and international organizations on the need for Nepal to adopt the cash basis IPSAS. Nepal has already developed Nepal public sector accounting standards by referring to the cash basis IPSAS in a close collaboration between the professional accountants and government officials. Attempts are being made to change the accounting regulations in order to incorporate the mandatory use of IPSAS.

Currently Nepal is planning to pilot the NPSAS in two ministry and then after may come up with new time lines and policies to adopt cash basis of IPSASs with subsequent platform to adopt/go for accrual basis on accounting of IPSASs adoption.

It is viewed that implementing IPSAS will not change the accounting system at any level and will only provide add on information to bring the Whole of Government (WoG) accounts in the IPSAS reporting format. To this purpose IPSAS, will pave the way for WoG reporting as a good practice now adopted by only few select countries.

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A Glimpse of Management Information System

- **Anupama Karkee**[26]

Information System:

Information **S**ystem is a set of activities for information processing, together with associated organizational resources, such as human, technical and financial, which provide and distribute the information. Links between objects and links between the system and environment are realized by information exchange. Each information system consists of the database and set of programme that provide various classes of users to access the data in that database so that they could perform their daily tasks. Based on that information, the information system can be defined as a set of techniques and technologies, methods and procedures for proper planning collection, preparation, transmission, warehousing and procession of data, based on the application of computers, as well as distribution and presenting of information for the use and decision-making.

Intensive development of information systems begins with introduction of computers and other equipment to the processing of so-called business information, which was so far performed by the people. Development of information systems as a whole has its basis, its boundaries and its motives. Today, the systems theory and informatics serve as a basis from which the design concepts of information systems development are derived. Information systems that use the computers and information technology (IT) in this field are called Computer Based Information Systems – CBIS. Thus an information system is a system consisting of the network of all communication channels used within an organization.

Management Information System (MIS):

Management Information System (MIS) is a system that provides information needed to manage organizations effectively. An MIS is a planned system of the collection,

[26] Ms. Anupama Karkee is accounts officer in PEFA Secretariat, Kathmandu, Nepal.

processing, storages and dissemination of data in the form of information needed to carry out the management functions. MIS involve three primary resources: technology, information, and people. It’s important to recognize that while all three resources are key components when studying MIS. The most important resource is people. MIS is regarded to be a subset of the overall internal controls procedures in a business, which cover the application of people, documents. Technologies, and procedures used by management accountants to solve business problems such as costing a product, service or a business-wide strategy. MIS is a set of processes or a system designed by organizations to collect, tabulate, and interpret data and information in an organized manner to provide a broad picture of the services and to guide management decisions. Generally, MIS has prescribed forms used for recording or collecting information. These forms should be sent in a timely fashion to the appropriate level or body within the organization for further processing, analysis, and feedback.

The manager should know the kinds of data generated as a result of the different services rendered by the organization. For instance an NGO offering some services will collect different data from an organization specializing in democratization and governance or the environment. In any case, managers and their staff should meet together to outline what information they absolutely need to know to function efficiently; these are the data that should be collected. Lists of data elements or variables collected should be periodically reviewed and updated. One saying is that always collect data you need & will use and never collect data just for the sake of collecting it.

The Functional part of MIS:

Management information systems provide decision-makers information and feedback on daily operations. Additionally, management information systems can be used strategically, often incorporating Web technology. MIS is multi dynamic in its application, providing us many functional aspects and scopes. We can enlist the function parts of MIS as follows:

- **Accounting management information systems:**

All accounting reports are shared by all levels of accounting managers. It starts from lower level management such as data collection to decision making level. Different types of software system are introduced for Accounting Management information system.

- **Financial management information systems**:
  The financial management information system provides financial information to all financial managers within an organization including the chief financial officer. The chief financial officer analyzes historical and current financial activity, projects future financial needs, and monitors and controls the use of funds over time using the information developed by the MIS department.

- **Manufacturing management information systems:**

More than any functional area, operations have been impacted by great advances in technology. As a result, manufacturing operations have changed. For instance, inventories are provided just in time so that great amounts of money are not spent for warehousing huge inventories. In some instances, raw materials are even processed on railroad cars waiting to be sent directly to the factory. Thus there is no need for warehousing.

- **Marketing management information systems:**

A marketing management information system supports managerial activity in the area of product development, distribution, pricing decisions, promotional effectiveness, and sales forecasting. More than any other functional area, marketing systems relies on external sources of data.

- **Human resources management information systems:**

Human resources management information systems are concerned with activities related to workers, managers, and other individuals employed by the organization. Because the personnel function relates to all other areas in business, the human resources management information system plays a valuable role in ensuring organizational success. Activities performed by the human resources management information systems include, work-force analysis and planning, hiring, training, and job assignments.

Advantages of MIS:

- It facilitates planning: MIS improves the quality of plants by providing relevant information for sound decision – making. Due to increase in the size and complexity of organizations, managers have lost personal contact with the scene of operations.
- In minimizes information overload: MIS change the larger amount of data in to summarize form and there by avoids the confusion which may arise when managers are flooded with detailed facts.
- MIS encourages decentralization: Decentralization of authority is possibly when there is a system for monitoring operations at lower levels. MIS is successfully used for measuring performance and making necessary change in the organizational plans and procedures.
- It brings coordination: MIS facilities integration of specialized activities by keeping each department aware of the problem and requirements of other departments. It connects all decision centers in the organization.
- It makes control easier: MIS serves as a link between managerial planning and control. It improves the ability of management to evaluate and improve performance. The used computers has increased the data processing and storage capabilities and reduced the cost.
- MIS assembles, process, stores, retrieves, evaluates and disseminates the

information.

Need for MIS:

This is a universally accepted fact that all managerial functions are performed through decision making. For taking rational decisions, timely and reliable information is essential and is procured through a logical method of information collecting, processing and disseminating to decision makers. In today's world of ever increasing complexities of carrying out business, every organization, in order to survive and grow, must have a properly planned, analyzed, designed and maintained MIS. This need is even more increased because organizations now have to compete not only locally but also globally. MIS assist decision makers, by providing the required information at various stages of decision making and thus greatly help the organization to achieve its goals and objectives. On the other hand, if an MIS is poorly planned and constructed, it may provide inaccurate, irrelevant or obsolete information, which may even prove fatal for the organization.

Different Types of MIS:

Transaction Processing System (TPS): It processes transactions and produces reports. It represents the automation of fundamental, routine processing used to support business operations. It does not provide any information to the user for decision making. TPS uses data and produces data.

Management Information System (MIS): MIS is an information system that processes data and converts it into information. A management information system uses TPS for its data inputs. The information generated by the information system may be used for control of operations, strategic and long-range planning, short-range planning, management control and other managerial problem solving.

Decision Support System (DSS): A decision support system is an information system application that assists decision-making. DSS tends to be used in planning, analyzing alternatives and trial and error search solutions. They incorporate a variety of decision-making models and thus area capable of performing what-if analysis.

Executive Support System (ESS): An ESS is a special kind of DSS. It is specially tailored for the use of chief executives of an organization to support his decision-making. Thus ESS is a comprehensive information system that includes various types of decision support systems, but it is more specific and person oriented.

Office Automation System (OAS): Office automation refers to the application of computer and communication technology to office functions. Office automation systems are meant to improve the productivity of managers at various levels of management by providing secretarial assistance and better communication facilities.

Business Expert System (BES): A BES is a knowledge based information system that uses its knowledge about a specific, complex application area to act as an expert.

Roles of MIS:

The Performance Monitoring Role

- To establish relevant and measurable objectives
- To monitor results and performances
- To send alerts, in some cases daily, to managers at each level of the organization, on all deviations between results and pre-established objectives and budgets.

The Functional Support role

Business processes and operations support function is the most basic. It involves collecting, recording, storing, and basic processing of data. Information systems support business processes and operations by:

- recording, storing and processing sales data, purchase data, investment data, payroll data and other accounting records
- recording, storing and processing inventory data, work in process data, equipment repair and maintenance data, supply chain data, and other production/operations records
- recording, storing and processing personnel data, salary data, employment histories, and other human resources records
- recording, storing and processing market data, customer profiles, customer purchase histories, marketing research data, advertising data, and other marketing records
- recording, storing an processing business intelligence data, competitor analysis data, industry data, corporate objectives, and other strategic management records
- use of all the above to implement, control, and monitor plans, strategies, tactics, new products, new business models or new business ventures.

The Decision Support role

The decision making support function goes one step further. It is an integral part of making decisions. It allows users to ask "What if…?" questions: What if we increase the price by 5%? What if we increase price by 10%? What if we decrease price by 5%? What if we increase price by 10% now, then decrease it by 5% in three months? What do we do if we are faced with a strike or a new competitive threat?

Limitation of MIS:

Once information is provided through the MIS, decisions can be made regarding the effectiveness of business operations. Limitations do exist with an MIS, such as the expense to create and implement an MIS, training time for employees, lack of flexibility and capturing wrong or incomplete information.

MIS implementation can be very expensive for firms looking to manage their operations more effectively.. Additionally, new employee hiring or employee training related to the MIS can also add to the implementation costs.

Properly trained employees are a critical part of an MIS. Employees are at the front lines of business operations and create or manage the daily activities of the company. The length and depth of the training may vary, making it difficult to estimate the cost of this training. Management will also have to account for the lost productivity during this training period.

Making changes quickly to reflect fluctuating business operations may not be possible depending on the MIS style and functionality. While correcting policies such as internal controls or operating procedures may be easy, company-wide changes such as service changes, production enhancements or marketing strategy may not be simple. Major business changes will require major changes to the MIS, leading to increased costs and downtime of information reporting.

Conclusion:

At each point, decisions must be made on the basis of available data. Moreover, once the program is under way, data for checking and analysis are required for effective monitoring and evaluation. Some programs will already have some of these data available. Where collection systems are lacking, they can and should be designed and implemented at all levels and locations.

An appropriate MIS is imperative for program managers to be able to monitor activities continuously, allowing them to direct resources where they will have the greatest impact. Record-keeping and reporting formats should be simple, user-friendly, and set up to collect only essential information. Existing formats should be reviewed and redesigned to ensure their appropriateness to integrated service delivery, as well as their uniformity and comparability among project sub-elements, project objectives, components, sites, and cadres of service providers.

Service providers, supervisors, and managers should be trained to monitor more effectively, to collect data, to interpret data, and to use findings in planning, implementation reviews, and management decision making. The service statistics system should be used not only to assess outputs and effects, but also to appraise staff and facility performance, set performance targets and assess performance against those targets, facilitate decision-making for optimal corrective action, and improve systematic planning. Such a system is at the heart of a sound monitoring and evaluation approach.

MIS helps a manager to collect and use information to make management decisions in a timely manner. Managers also use MIS data to analyze, plan, make decisions, take actions, and evaluate. An effective MIS provides accurate, complete, and timely information. However, some limitations of MIS are still remains such as: Shortage of competent staff, Complexity of instruments and cumbersome procedures, Incomplete and inaccurate records with omissions of relevant data, Duplication of data, Poor data storage, Financial constraints, Shortage of material, Bulk of unprocessed data, Coordination of data and data related processes etc. in the absence of MIS organization could not accomplish the activities properly and it will be the challenge for organization.

MIS formats should include feedback mechanisms so that decisions made at all levels within the organization can be shared with and enriched by stakeholder inputs. Such feedback is often stimulated when data are analyzed and shared, and issues are highlighted. Staff must be trained to use MIS outputs and data generally to support their work and make it more efficient. Data must also be reported, shared, and used for problem-solving and sustaining program and organizational momentum.

MIS in short computer based information system and it can be said as all information system related to computer. MIS now in knowledge era, that means a machine which treat as a human using human brain. Robot is the best example of knowledge era MIS.

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Beyond the Box

Say Workfare not Welfare

- Durgesh Kumar Pradhan[27]

Change for betterment is development. Therefore, rising aspiration of people for development is natural. Development is not the windfall product but it is the product of diligence. Dedication generates development. In fact, development is never achieved without cultivating the culture of working with due diligence. Perhaps the maxim of 'god helps those who help themselves' also supports this doctrine.

In Nepal, translating into action instead of making a slogan for development is the main challenge, at present. In this context, system of workfare rather than welfare could be the better remedy in overcoming the chronic syndrome of avoiding work that affected most people.

Principles are always good. But a success of plan and programs lies not in mere words but in implementation. Implementation is crucial in Nepal. The culture of avoiding work and responsibility is the phenomenon of bureaucracy and it is difficult to find large group of staff during the complete official time in the office. However, certain numbers of staff keep dragging entire responsibility of the organization even not considering official time. However, it is not fair to differentiate between performer and non-performer neither in the benefits nor in the remuneration according to law. Actually this is the syndrome, easily diagnoses every one, affecting as barriers in our economic prosperity and national development. Nothing else would change the attitude without differentiating performer and non-performer monetarily and in terms of reputation. It needs systematic reform instead of parametric. In this context, workfare rather than welfare would augment changing attitude and sensation for taking responsibility and ownership.

[27] Mr. Durgesh Kumar Pradhan was worked as a undersecretary in Ministry of Finance.

Although the term 'Workfare' was first introduced by civil rights James Charles Evers, 1968 and popularized by Richard Nixon in 1969, it seems that it would be more practical in motivating towards the work. Workfare aims to break the cycle of poverty where welfare dependence can become a way of life and to help people involving in the activities of income generation where self reliance can experience through own effort and wit. In fact, establishing linkage between work and assistance instead of providing free is the key principle of workfare. The workfare believes in the income equal work performance. It leads in the effective and efficient performance. Moreover, it concentrates even for the innovative ideas and technologies for accelerating performance. Therefore, it believes in providing necessary support to develop capability and efficiency instead of providing support just for existence.

Beside drain on fiscal resource, system of welfare makes people dependent and parasitic, which lose prerequisites of development like self-confidence, energetic, dignity, ownership, accountability so on. Furthermore, once a person accepts for the welfare, it erodes the work ethics and changes the working habit. Habit is the second nature of man, which spoils entire enthusiasm, dedication and sense of ownership. It ultimately affects in the overall economic growth and national development. As system of welfare could sink into such a vicious circle from where it is not possible to rise, workfare is to be followed for development. However, workfare does not mean not to look after people with disabilities, seniors and young children. Main theme of workfare is to emphasize on work and to provide sense of responsibility and ownership. In this connection, the programs like food for work, self-employment program, performance incentives schemes launching at present are certainly prudent drive towards the workfare system, which could say moving towards right direction.

Welfare is very melodic in hearing but it is very painful from the aspect of sustainability. Therefore, focus to be given for the workfare so that individuals make efforts for their own. 'While making efforts for own-self to lift up, it will be easy to drag up.' It is so as per principle of workfare. In this circumstance, it would be easy from the success and sustainability aspect as the effort for lifting up make from the both-side state and people, employer and employee, donor and recipient. This leads in providing sense of obligation to each individual, and it facilitates to smooth the process of development.

It is known to all that giver will be on the upper hand and recipients take themselves dominated, psychologically. It is not fair from the point of humanization. Workfare is a system that would cause to bring forth contribution of individuals up to their capacity and this would automatically eliminate sense of domination. Thus, workfare avoids sense of dehumanization.

In this regard, the economic growth of Singapore inspires every one that emphasizes on system of workfare instead of welfare. It provides more incentives for individual to work and give attention to spread the culture of working. The prime motto of all of us is to have betterment. The system for the betterment must be commensurate with the time and situation. The anatomy of one country is different from the other. Hence, just replicating the system that led to success in one country, might not get success equally in other countries. However, we have experienced welfare system and it has taught us for demanding rights about welfare but excluding duties. The state has made the effort to fulfill only demands of those who could pressurize. Of course, rights and duties are the two faces of the same coin. Making apart to rights and duties is the main blunder in the existing welfare system. Workfare is such a system, which carries rights and duties together. Therefore, in order to augment our initiatives towards the desired target of prosperity and national development let us demand and say workfare not welfare.

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Ministry of Finance

PEFA Secretariat

Anamnagar, Kathmandu, Nepal

Phone: 014770706/014770387

e-mail: pefanepal@pefa.gov.np

Web Address: http://www.pefa.gov.np