EDITORIAL

The Constitution of Nepal (2015) has changed governance into federal system which will lead to restructuring in legal, administrative, financial and social sector. Public financial Management (PFM) being at the heart of all these reforms has major responsibility to internalize all the changes and reforms for balancing stability through economic responsiveness.

Being focal point of the institutional, technical, administrative and political capacities of government PFM reform activities should be well focused for effective implementation of new system and harmonize all dimensions of governance. If the expectation will be met PFM will not only help the country to establish good governance but also assist to achieve sustainable economic growth. But even after a decade, many fundamental reforms in PFM remain to be completed, and effective past reform initiatives are being rethought for updating and sustainability in newly applied three tier governance system. Hence, the challenges that PFM reform Nepal is facing in transition that strive to achieve an acceptable standard of performance in PFM sector will be even higher and a sound PFM reform can be a panacea for all the challenges.

The journal is just an instrument to highlight the gaps through the subjects that encompasses issues related to PFM reform, social security, fiduciary risks minimization and explores the optimal path of oversight such as legislative oversight at micro level. At macro level it circumferences issues such as fiscal policy and economic growth. We hope the discourses though is brief will be helpful to retrofit the cracks between policy and practice around the ecology of Public Finance Management in Nepal both in terms of depth and breadth of coverage and its specific orientation towards the need of reforms in the PFM. Some of the articles contained in this issue may be more relevant with the previous structure of the government and that could be replicated as well as refabricated during the transitional phase. We hope that this journal will be useful as a basic reflection to lubricate the course of actions for the same to the policy-makers and practitioners, or as part of educating program to all referring and learning groups.

- PEFA Secretariat
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Whither Public Financial Management Reforms?

- Suresh Pradhan*

Abstract

Nepal has been struggling to streamline Public Finance Management (PFM) and monitor the government institutions for their effective functioning. In this perspective this article mainly targets to highlight PFM reforms initiatives in Nepal and its major shortcomings. It also suggests remedial reform measures to overcome these weaknesses and shortcomings.

Key Words

Public Finance Management (PFM), financial accountability, Public expenditure, financial management, Public Procurement Act, Financial Procedure Act.

Introduction

Every government has its objectives of securing law and order as well as achieving economic development to raise living standards of its people. In these endeavor government frames policies, develops programs and projects and assigns functions to state institutions to perform. In order to carry out these functions Public Financial Management (PFM) plays a pivotal role which looks after financial spheres of the government. In its process of functioning PFM mainly functions through financial planning and programming, budgeting and revenue management, debt management, expenditure management and associated functions such as reimbursement, public procurement, accounting, recording as well as financial reporting. In addition, it also covers internal control and audit, final audit and external scrutiny. Through these functions, PFM aims to achieve aggregate fiscal discipline; develop a predictable, transparent and accountable financial governance system and institutionalize the good governance practices. Nepal has its own system and initiatives to strengthen PFM and enable government to achieve the goals of its development plan and state functions. Nepal has been striving to modernize PFM and guide the government institutions

* Joint Secretary, Ministry of Cooperatives and Poverty Alleviation
for their effective functioning. In this perspective this article mainly aims to highlight PFM reforms initiatives in Nepal and its major shortcomings. It also suggests remedial reform measures to overcome these weaknesses and shortcomings.

**PFM Reform Initiatives**

Government of Nepal (GoN) has implemented and initiated many fundamental and useful PFM reform initiatives in Nepal. So the reform has been one of the remarkable areas that have delivered measurable results in the state performance mainly during the last three decades. The reform is seen even today as the continuous process. The major reforms can be listed below as:

**Legal Reform:** GoN has promulgated various legal provisions to regulate and reform PFM in Nepal. As the major instrument, PFM has special provision in Constitution of Nepal 2072. This has mandated the government for presentation of revenue and expenditure, consolidated fund and its operation procedure etc. To make it operational, there are Financial Procedure Act (FPA) 2055 and Rules (FPR) 2064, which mainly guide the govt. officials in budget formulation, program preparation, expenditure procedure, irregularities settlements etc. Civil Service Act 2049 & Rules 2050 have been framed to regulate management and compliance of consumption expenses (salary, allowances, TADA etc.) and Service Contract for blue colour jobs such as computer, office maintenance and security services etc. In addition to this, GoN promulgated Public Procurement Act (PPA) 2063 and Regulation (PPR) 2064 for the improvement of public procurement system and attainment of transparent, open, objective and accountable governance in public procurement. These legal arrangements have basically framed the legality of GoN financial transactions.

**Budgeting:** Similarly, Incremental budgeting which is based on past years appropriation/expenditures (generally 10 percent increment) has been in operation and has been supplementing through program budgeting, which is based on the cost estimation and programs activities. This has enabled GoN to make the budget appropriations more objective, measurable and verifiable. A recent initiative to orient the budgeting system as Medium Term Budgeting System (MTBF) initially in Education and Health sector-
has made arrangements for making accountable the ministries for the priority and getting results and putting Ministry of Finance (MoF) as monitor and supervisor position keeping the results in the responsibility of concerned line ministries. And recent use of Line Ministry Budget Information System (LMBIS) has further made the budgeting preparation more accurate, transparent and information technology based.

**Expenditure Management:** A remarkable reform can be seen in this field. A good example is the adoption of Medium Term Expenditure Framework (MTEF) from Fiscal Year 2002/03 Budget. This framework has enabled the planning and budgeting authorities to link between the Plan/Poverty Reduction Strategy (PRS) with annual Budget and its resource allocation. This enabled to ensure implementation of the Plan/PRSP through credible budget. This framework has the features of Prioritization of all programs and activities, changing budget and fund release procedures to ensure greater predictability in funding for priority activities and also Improvement in resource allocation pattern among sectors (inter-sector) and within sectors (intra-sector).

**Treasury Operation/Budget Release:** Most visible reform has been in the sector of treasury operation and budget release procedure in the history of PFM reform. In the reform process before establishment of District Treasury Comptroller Offices (DTCOs) in 2038 (B.S.) Budget was centrally released by Financial Comptroller General Office (FCGO) and Ministries/Central Agencies on *yearly basis* through Checks to Field Offices. After 2038 (B.S.) DTCOs in districts established and started Budget Release on Trimester / Revolving Fund (after 2052 (B.S.)) on *Trimester and monthly* basis. Treasury Single Account (TSA) which was implemented from 2066 (B.S.) made a provision to issue checks from DTCOs as per Spending Units request on *daily basis* in the formats developed as 14 & 14 ka Forms and operated one-gateway for government payments as and when expenses incurred (Using TSA-DECs Software). This enabled GoN to get real time basis information about revenue and expenditure instantly, which can be regarded as historic achievement in the field of PFM.

**Accounting System:** The accounting system development in Nepal reflects extensive focus on budget expenditures rather than many other important
aspects of the budget and budgeting to development partners. As a result, several gaps were envisaged in the newly institutionalized accounting (From 2017 B.S.) to put an emphasis on the continuation of accounting-sector reform (*Based on need appropriation, Revenue, Deposit, Works, Inventory, Project Accounting etc.*). Recently, commitment control for more than 0.5 million contract amounts has been introduced after TSA implementation which is a milestone in PFM reform in accounting. In addition, Nepal Public Sector Accounting Standard (NPSAS) has been started since 2009 (AD) and financial reporting of GoN has been prepared in the NPSAS Format as per the NPSAS Standard (10). The revision of Charts of Accounts (CoA) as per International Monetary Fund 2001 Guidelines has enabled to make the system at par with international classification for uniformity and comparison. Previously the budget used to be classified as regular and developed budget. The classification now termed as Recurrent, Capital and Financing budget.

**Foreign Aid Modality:** Another reform has been done in foreign aid modality. This reform was to introduce program aid instead of foreign project aid and reduce interference of donors in projects expenditure/procurement, budget release and expenses. This also started multi donor financing through Sector Wide Approach (SWAP) to address and facilitate matching fund problem. It is being piloted and implemented in Health and Education Sector. This has been facilitating in settling obstacles from lack of GoN sources as matching fund and also in reimbursing of Donor Funds. This reform also has facilitated administration of donor's resource.

**Increasing Use of IT:** A series of PFM reform has been made through use of Information Technology (IT) in Nepal. Among them, use of TSA-DEC Software for facilitating the TSA operation and Budget Control is notable reform. Similarly, Revenue Management Information System (RMIS) to manage revenue accounting, Computerized Government Accounting System (CGAS) for operational accounting, Financial management Information system (FMIS) to manage database and produce required reports as & when needed, Line Ministry Budget Information System (LMBIS) for online budget preparation, BMIS to give direct Authority to the spending units under the given ministry, e-Payment (in Process) may be the significant reform for direct payment to concerned parties from government treasury.
Public Procurement: Another milestone in PFM reform can be seen in the field of procurement activities and procedures of Public Entity. This previously was being administered by FAR. As per recommendation of Country Procurement Assessment Review (CPAR) 2002) conducted jointly with The World Bank, a new and separate Procurement Act has been promulgated in 2063. This separate act and public procurement rules 2064 have been managing procurement system towards objective, transparent, timely, plan based and result oriented. Recent development of e-Procurement has been enabling public entity to manage artificial obstruction of goons in bidding process and making transparent public procurement. Similarly, the institutional arrangement of Public Procurement Monitoring Office have reached on consensus to deal the procurement as specialized function for making public procurement process an effective and efficient one.

Fiscal Rules/Transparency: Fiscal control has been introduced to PFM reform. This has made a provision on budget transfer for putting ceiling only up to 10 percent of the budget of the Fiscal Year, prohibition on the transfer of Capital to Recurrent Budget Head, restriction of Domestic Borrowing 5 percent of GDP, use of CDRMS for Debt management, and Mid-Term Budget Review by MoF for performance review. Under this provision submission of monthly expenditure/Advance/Bank Statements and Annual Financial Statement by MDA spending unit to FCGO and Central Consolidated Financial Statement by FCGO to OAG must be made on yearly basis.

Accountability: As per FPA 2055 & FPR 2064 accountability has been restored in official who get Expenditure Authority. The chief accounting officer also termed as "Responsible Person" is the prime official for holding accountability on behalf of concerned ministries/central agencies and "Accounting Personnel" in every spending unit. Every such official's duties and responsibilities have been specifically defined. PEFA has also been using 31 Indicators for measuring the PFM accountability in Nepal. The assessments conducted in 2008 & 2014 have shown that there have been gradual improvement in accountability in PFM of Nepal with some exceptions. The role of Public Accounts Committee, Auditor General
Office, National Vigilance Center, and Commission for Investigation of Abuse of Authority to achieve this status is notable.

**PFM Performance Status:** In the face of above arrangements, system development, reform and improvements, present status still depicts a sorry state of PFM performance in Nepal. There have been problems of governance and financial indiscipline as indicated by growing irregularities revealed in OAG yearly reports. The following 3 years table about irregularities illustrates these facts:

**Percentage of Irregularities of GoN Offices in Total Irregularities**

*Of the reported Fiscal Years 2069/70 – 2071/72 (B.S.)*

<table>
<thead>
<tr>
<th>Type of irregularities</th>
<th>Sub-Category of Irregularities</th>
<th>Fiscal Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>69/70 70/71 71/72</td>
</tr>
<tr>
<td>1. To be Recoverable</td>
<td>To be Recoverable</td>
<td>10.24 9.62 8.60</td>
</tr>
<tr>
<td>2. To be Regularised</td>
<td>Non Compliance</td>
<td>16.17 14.86 11.28</td>
</tr>
<tr>
<td></td>
<td>Non-submission of documentary evidence</td>
<td>32.43 31.55 33.35</td>
</tr>
<tr>
<td></td>
<td>Balance not Carried Forward</td>
<td>0.12 0.24 -</td>
</tr>
<tr>
<td></td>
<td>Reimbursement not obtained</td>
<td>2.66 2.31 0.63</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-Total</strong></td>
<td><strong>51.38 48.96 45.26</strong></td>
</tr>
<tr>
<td>3. Advances</td>
<td>Staff Advances</td>
<td>0.57 0.80 2.78</td>
</tr>
<tr>
<td></td>
<td>Mobilisation Advances</td>
<td>12.34 18.82 18.73</td>
</tr>
<tr>
<td></td>
<td>Letter of Credit Advances</td>
<td>8.55 12.30 6.72</td>
</tr>
<tr>
<td></td>
<td>Corporate/ Institutional Advances</td>
<td>16.92 9.50 17.91</td>
</tr>
<tr>
<td></td>
<td><strong>Sub-Total</strong></td>
<td><strong>38.38 41.42 46.14</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Grand Total (%)</strong></td>
<td>100 100 100</td>
</tr>
</tbody>
</table>

The above table shows that in the last 3 FYs, of the total irregularities the recoverable amount percentage has been decreasing. Similarly, the table also
depicts that in the category of *irregularities to be regularized* the trend shows that except *non-submission of documentary evidence* all other forms of irregularities in that category have been decreasing. This exceptional lacking hints towards a serious mismanagement of budget and resources, accounting and internal control system which may lead towards *fiduciary risks*. It also casts doubts about intention of the concerned authorities (including account personnel) for expenditure mismanagement (except justified and regularized by appropriate authority in hierarchy). Similarly, it also reflects the root of financial indiscipline and misuse of financial resources. If this situation will persist then all reform procedures need a serious revision towards that direction. The table also indicates that advances have still been a major source of irregularities especially the mobilization advances. The trend points out towards defects in the contract management. This could have been avoided with good contract management and use of accounting provisions to record such irregularity in the ministry, by the use of 10 OAG forms developed and reformed for this purpose. This also portraits the carelessness of the respective contract managers along with accounting personnel. It needs immediate attention as public has been eyeing this as the symptom of corruption.

Like irregularities of financial nature, the management aspects of PFM of government entities also possess serious problems as reported in OAG 2072 report. The major observations reveal that this nature of deficiencies has been a continual phenomenon and improvement measures have not been effective yet. Some of the major anomalies are summarized as below:
<table>
<thead>
<tr>
<th>Type of Anomalies</th>
<th>Probable Reasons</th>
<th>Suggested Corrective Measures</th>
</tr>
</thead>
</table>
| **Weak Project Management:**             | Project Implementation without preparation, Problem of project prioritization, No progress as per target set, National Flagship project run not as planned, low utilization of foreign aid, Lack of adequate budget | • Budget and Program approval without adhering the financial procedure law  
• Non-adherence of Medium Term Fiscal Framework (MTFF)  
• Wrong PFM sequence reform  
• Lack of funding and implementation experience of authorities involved in foreign aid and budgeting | • Make line ministries accountable through MTBF  
• Make accountable to MoF and NPC for budget / program approval for programs/projects for not adhering Financial Procedure Law and Directives  
• PFM Sequential reform MTFF, MTBF and MTEF in place  
• Budgeting Reform through Performance Budgeting |
| **Financial Transactions Accounting:**   | All financial transactions are not included in the Consolidated Fund, Emergency Relief Expenditure not recorded, GoN Accounting does not reflect true & fair view, Internal Control not developed and monitored by the ministries, | • Weak accountability enforcement by PAC  
• Governance weakness of the concerned authorities (mainly OPMCM, MoF, NPC, FCGO)  
• Lack of accounting reform in the form of responsibility accounting  
• Lack of accounting acumen in accounting officers and authorised officials  
• Financial performance not a | • Mandatory provision of inclusion of every financial transactions in budget by line ministries, MoF, NPC, Parliament  
• Strong enforcement by PAC in the negligence of budget and accounting performance  
• Improvement of Accounting system towards Commitment and Accruals accounting along with Cost and responsibility accounting by MoF and |
| Internal Audit not effective | performance measurement factor in work evaluation  
- Chief Accounting Officers not held responsible for weak performance in the financial progress | FCGO  
- Financial performance should be the indicators of officials and financial officers involved in financial matters by Concerned Ministries, MoGA, OPMCM, MoF and FCGO. |
| --- | --- | --- |
| Serious Weakness in Public Procurement Management:  
Contract Agreement not in time, Extension of Time after expiry of completion time, No recovery of Liquidated Damages, Action not taken even after Completion of time, Work addition through Variation, Payment of ineligible Price Adjustment | Formality of procurement plan during budget and program approval by MoF, NPC and Line Ministries and almost non-monitoring of this plan  
- Contract agreement are not well thought about (LD, price adjustment, EoT, Variation) the said provisions  
- Lack in punitive actions to contractors for their non-performance as per contractors and professional conduct  
- Weak contract administration and officials not held responsible for bad administration | Mandatory provision to approve procurement plan as per program of line ministry along with approval of budget and program by MoF, NPC. Make accountable those agencies if they do not comply with the provision.  
- Practice of punishment to contractors be made effective and system of Blacklisting need more action.  
- Review of project problems also need to base on procurement plan's progress.  
- Punishment of officials should be based on progress of such plan  
- Strict adherence of contract administration by concerned officials |
| Severe Budget Indiscipline:  
Expenditure through | Budget not based on cost norms, program rather mere incremental;  
Introduce performance budgeting basing it on norms, programs and | |
<table>
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<tr>
<th>Miscellaneous (Bhaipari) account, More Expenditure than net budget, Non-inclusion of Foreign Aid in Budget, Technical Assistance/Commodity Aid, Virement against Financial Procedure Law, More budget in Grants but not monitored, Expenditure Authority not in time</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Virements without ascertaining proper budget ceiling</td>
</tr>
<tr>
<td>• Non-adherence of Financial Procedure Law about budget formulation and Foreign Aid Policy by MoF, NPC.</td>
</tr>
<tr>
<td>• Lack of enforcement of budget as government accountability by parliament and specifically by PAC</td>
</tr>
<tr>
<td><strong>Discharge of Responsibilities:</strong> Responsible authorities are not serious about settlement of audit observations within given time, Problems of non-implementation of Public Accounts Committee (PAC) decisions, Growing Irregularities.</td>
</tr>
<tr>
<td>• Negligence of officials in financial transactions</td>
</tr>
<tr>
<td>• Non-enforcement of punishment clauses for violators</td>
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<tr>
<td>• Financial performance/results not used as indicators of Work Performance evaluation</td>
</tr>
<tr>
<td>• Make irregularity as an indicator of work performance evaluation of officials involved in financial transactions and monitored by PAC</td>
</tr>
<tr>
<td>• Enforce strict punishment based on FPR punishment clause and for negligence of officials involved in financial transactions for non-incorporating all transactions in budget and non-adherence of FPA &amp; FPR by concerned ministries, AGO &amp; PAC.</td>
</tr>
<tr>
<td>• Prepare Grants Manual and enforce it, make grants output based</td>
</tr>
<tr>
<td>• Budget presentation, Authority &amp; Budget allocation should be given in time</td>
</tr>
<tr>
<td>• Enforce the violators of financial rules through Financial Responsibility Act.</td>
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</tbody>
</table>
Way forward

Despite of good and noticeable PFM reform measures through the ages in Nepal and have a good rating in financial accountability (PEFA), the fundamental aspects of accounting with good evidence and supporting documents and growing irregularities have still been posing a great challenge in Nepal. Moreover, negligence in PFM by responsible officials by repeating in year and again has been another serious issue that need an immediate attention. All efforts in PFM reforms have been shadowed by such results and behaviors. This is a serious problem because actually this situation has been harshly threatened the financial indiscipline and PFM. So now the policy makers and PFM implementers need to think it seriously about it. In a resource ridden country like Nepal, this situation shall not be justifiable. Therefore, as mentioned in the above table the reform measures outlined need to be addressed. However, as fundamental reform GoN need to enforce Accounting Manual, reform budget through Performance Budgeting and reform accounting system through commitment, cost and accrual system. This should be followed by strict adherence of punishment measures for the accountable and responsible officials as per the FPA, FPR, PPA, and PPR along with performance contract with the concerned authorities.

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GoN, *Public Procurement Rules, 2064*, Kathmandu


***
Abstract

The institutional, technical, administrative and political capacities of the state are now as important as they ever have been. Good government continues to be an absolutely necessary prerequisite for successful economic growth in the developing world. One of the most effective ways to strengthen the basic capacities of the state is through the construction of an honest, efficient, and effective (or in other words, accountable) bureaucracy.

In ancient times accountability was in order only when grave situations i.e. disasters were visible. Accountability involved control and answerability, often related to sanctions having personal consequences, and aimed at righting wrongdoings. So, Public accountability is becoming more and more important. The perception and the practice towards accountability are changing with the time.

As Village Development Committee (VDC) is a first door of service delivery from the state, so the accountability is most from the jerk. It needs to highly accountable to the society. In this context, this study is conducted to explore the situation of financial accountability of the VDC secretary of Nepal.

The study follows qualitative research approach with focus on its philosophical premise, which encompasses ontological, epistemological and methodological assumptions. The study adopted the interpretive paradigm in order to derive substantive meaning from the people’s everyday practices and their interpretations of those practices.

The study was conducted in twelve VDCs of Dang. Data were collected through interview and observation. The findings of the study indicate that despite the components of good governance i.e. service delivery, public financial management and financial accountability are practiced by the VDCs; it was poorly executed during the implementation procedure. There were immense gaps among the system, provision and execution.

* Joint Secretary, Public Procurement Monitoring Office.
Key Words

Village Development Committees, financial accountability, Public expenditure, financial management, good governance, Social Security Entitlement.

Introduction

VDC is a primary institution of the state to deliver the service to the people. The ultimate responsibility of the government is to serve the people. People have paid their tax to the government. The recipient should have the responsibility for the public money. On the other hand, the public want to know about who looks over the public expenditure in the public entities, how they manage the public fund and what is the mechanism to spend the money properly. Besides, they also want to know how the accounting, recording and reporting system are maintained in the public entity and also about the people involved in the financial management. So, It should be accountable to people and should maintain the general norms of good governance. One of the components of good governance is accountability and to be accountable to the people, the financial part is most important. Reid, (2003) had quoted that "being financially accountable means to be obliged to give a reckoning explanation or account of one's actions and decisions regarding the use of money entrusted to one's care" (Reid, 2003, p .5).

According to ADB (1999), the question of the mechanisms by which the people's preferences are ascertained, political accountability is obtained, and government action is monitored, is central to politics and is very important, but is outside the scope of this analysis (as well as beyond the mandate of international development institutions).

According to the PEFA report (2008) the assessment of Nepal's performance in PFM suggests a system that it is generally well designed but unevenly implemented. The budget has become a policy tool that is largely credible. It is clearly linked to policies in some sectors with solid control of aggregates and has a reasonable control framework at the transaction level (notably for payroll). However, there are gaps in the control framework and implementation, and large fiscal activities remain outside the scope of the Government budget (p. 2). It is seen that the voice of PFM organizations has focused on measurement of performance in public financial accountability.
Social Security Entitlements (SSEs) in Nepal

The origin of these SSEs in Nepal began in 1994. As noted in a newspaper article:

“A universal flat pension of Rs. 100 to all the elderly people above 75 years was first announced in Nepal on December 26, 1994. Since 1996-97, the Ministry of Local Development has been administering the Old Age Pension (OAP), and the allowances were distributed by the ward offices in the urban areas and by the VDC in the rural areas. In 2007, a major step forward was taken by the Interim Constitution in recognizing social security benefits as a fundamental right of a citizen protecting them against socio-economic distress. This year, the government has also reduced the eligibility age threshold for Dalits and Karnali zone citizens. In FY 2010/11, 3.01% of the total budget was allocated to social security programs”.

The Government of Nepal (GoN) guaranteed access to social security identifying a range of provisions, including for “entitlements”, which were now affirmed as rights established by the legislation in 11 categories. Of the 11 categories of SSE, senior citizen, widows and disability categories account for the largest numbers who receive the largest budget allocation.

A Nepali with the paperwork issued to prove s/he is above 70 years of age or above 60 years of age if a Dalit or a Karnali region resident, and not receiving any other pension or social security, is eligible for a GoN old age SSE. Similarly, a Nepali woman whose spouse has passed away or who has not remarried, is not receiving any other pension support and has documented proof such as an ID issued by the VDC identifying the person as a widowed single woman is eligible for SSE, irrespective of her age. Any Nepali who is certified by authorized government line agencies as fully or partially disabled is eligible for a SSE under the disability category. The table below provides the list of all SSE categories and the monthly entitlement amount.

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Table 1: Entitlement Categories and Monthly Entitlement Amount

<table>
<thead>
<tr>
<th>S. N.</th>
<th>Entitlement</th>
<th>Amount (Per Month)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Senior citizens above 70 years</td>
<td>1000</td>
</tr>
<tr>
<td>2</td>
<td>Senior citizens Karnali region above 60 years</td>
<td>1000</td>
</tr>
<tr>
<td>3</td>
<td>Senior citizen Dalit above 60 years</td>
<td>1000</td>
</tr>
<tr>
<td>4</td>
<td>Single woman above 60 years (Never Married)</td>
<td>1000</td>
</tr>
<tr>
<td>5</td>
<td>Single woman above 60 years (Divorced)</td>
<td>1000</td>
</tr>
<tr>
<td>6</td>
<td>Widow any age</td>
<td>1000</td>
</tr>
<tr>
<td>7</td>
<td>Dalit children (Under 5 years up to 2 children)</td>
<td>400</td>
</tr>
<tr>
<td>8</td>
<td>Karnali Region children (up to 2 children under 5 years)</td>
<td>400</td>
</tr>
<tr>
<td>9</td>
<td>Disabled (Partially)</td>
<td>600</td>
</tr>
<tr>
<td>10</td>
<td>Disabled (Fully)</td>
<td>2000</td>
</tr>
<tr>
<td>11</td>
<td>Ethnic / Indigenous group members at risk of extinction</td>
<td>2000</td>
</tr>
</tbody>
</table>

Source: Department of Civil Registration, GoN.

DDCs provide the VDCs a full disability allowance budget for a fixed number of persons with certified full disability. The DDC is in turn provided a full disability allowance budget for a fixed number of persons with full disability by the Centre. This is the reason why (as reported by the CSOs) in some of the VDCs even those eligible for fully disabled were receiving entitlement amounts for the partially disabled as there no longer was “space” in the entitlement list to include more of the latter. Due to lack of space, the paperwork certified them as partially disabled even when another citizen with the same disability was receiving the fully disabled entitlement.
Payment of Entitlements

Are Citizens Receiving Their Social Security Entitlements at Right Time and Right Amount?

Entitlements are paid thrice a year, on a quarterly basis as specified in the Resource Mobilization Guideline (revised 2069 BS) issued by the Ministry of Federal Affairs and Local Development:

Table 2: Entitlement distribution Calendar

| i.  | First installment Bhadra 1 to 31 (August 15 – September 15) |
| ii. | Second installment Poush 12 to Magh 12 (December 25 – January 25) |
| iii. | Third installment Baisakh 15 to Jyestha 15 (April 30 – May 30) |

The end dates are those by which entitlements have to be disbursed. According to the guidelines, any claimant unable to collect her/his entitlement on the stipulated date of disbursement may do so on subsequent dates where s/he is paid both the amounts – that due and that overdue. However, if the claimant misses collecting the entitlement amount during the third and last disbursement date in a fiscal year, then that particular amount cannot be carried over to the next fiscal year, and thus lapses.

Methodology

Methodology describes the research design, selection of field, source of information, selection of research participants, data collection procedures, review of documents in the VDCs, data analysis procedure, triangulation, quality standards and ethical considerations.

The whole study is guided by the Ontology and Epistemology. Ontological perception is relativist because reality is not fixed and universal but depends on particular context, time, place and other influencing factors as well. Epistemological stance is subjectivist because our knowledge of the everyday world inheres in social order and this world itself is socially ordered. Socially constructed realities are different from situation to situation and this world is shaped by multiple realities.
This study has mainly focused on the exploratory qualitative aspects. It based on the exploration of receiving social security entitlement by the beneficiaries and financial accountability of the VDC secretary with expenditure tracking as practiced by the VDC secretary. Likewise this study also drew upon concepts of ethnographic research traditions. The study has explored the perception of social security entitlement holders by survey, interview and observations.

Research manuals, research reports/dissertations, various journals and articles aided in the completion of the study. Distribution process and committee verification approach was observed. Financial statement of the VDC including income and expenditure statement, receipt and payment statement and minutes were reviewed. The audit reports were also reviewed and that helped to find the situation of financial accountability performed by the VDC secretaries and to support to reach the conclusion of the study.

**Survey Implementation and Data Analysis**

Overall twelve VDCs were selected from Dang District in this study. Bijauri, Dharna, Gadhwa, Gangaparaspur, Halwar, Lalmatiya, Laxmipur, Narayanpur, Saudiyar, Sisahniya, Tarigaun, Urahari were selected as the field for this study. The purposive sampling has been employed for the selection of VDCs. Both primary and secondary data were used in this study.

The data set includes SSE recipients from different situations prevalent in Nepal, although it cannot be considered a truly representative sample of Nepal. The very large number of cases from a varied situation makes it a unique data set. There were 34 questions, of which one was qualitative seeking suggestions about ways to improve the SSE, and the remaining 33 questions sought to collect quantitative data around SSE. Each individual interview was intended to take 20 to 30 minutes.

The VDC secretary, technical assistant working with the VDC, social mobilizer and beneficiaries, were the respondents of this study. The participants of the research were randomly selected. The secondary data has been taken from the VDC records, publication from Ministry of Federal Affairs and Local Development (MoFALD), DDC records, journals, booklets, newspapers, and published and unpublished documents from various sources.
Open-ended and unstructured interview indicates that the study is a qualitative research. This study followed open-ended semi structured interview. Key people such as VDC secretaries, social mobilizers, accountants and beneficiaries were interviewed to elicit the required information. Regarding the process and implementation, budget allocation, release system, SSE distribution reporting system was observed. The observation focused on the process of budget formulation, allocation, and release system and distribution mechanism to the beneficiary in the sample VDCs. The observation assisted to elicit the status of receiving the social security entitlement as per the provisioned. It helped to assess that, is the citizens receiving their Social security entitlements at right time and right amount?

After collecting the data through above-mentioned tools from different respondents and sources, it was processed in different steps. Firstly the data collected from interview was transcribed in the paper. Themes and sub-themes were generated from the responses obtained from the interviews and observations. Analysis and interpretation of those themes and sub-themes were done in a descriptive and explorative way by the help of theory. This process helped to do multilevel analysis of triangulation, corroborating the finding from one type of data analysis with evidence from another type, and using qualitative observation, in-depth interviewing and document analysis. Then with help of theories the analyzed texts were interpreted and summarized.

**Major findings and Discussion**

Most of the citizens were more likely to know the month when entitlements were distributed rather than the actual date. One reason for this could be attributed to there not being any fixed date of entitlement disbursement with the dates varying for each of the three installments and being different each year, as well. Secondly, the way the entitlement disbursement times were popularized related more to a particular time of the year – e.g., before the festival season, before the onset of winter, right around spring beginnings. Citizens were thus more likely to remember the disbursement time than dates, which were not fixed anyway.

The entitlement budget that was to be sent to the VDC from the DDC did not come at fixed times or on fixed dates. The norm was that the SSE should be distributed by a certain date as specified in the government authorized resource manual rather than on a certain date, so there was a flexibility around dates that
was built into the disbursement process itself. Similarly, senior citizens were happy to receive the allowance at their ward or village although, most of the VDC secretary has their own mechanism to reach and distribute the allowance to make the effective service delivery.

It was found that VDC secretaries, social mobilizer and beneficiaries or stakeholders were well acquainted with the Social Security Entitlement provision in the local level. Their perception on the provision of social security allowance and policy of the government were matched with the elements of Government of Nepal Social Security Program Implementation Guideline. They were also well known with the process of carrying out all the activities of SSE in the VDC. Beneficiaries were happy to know the distribution system was being transformed to banking system instead of cash distribution in hand.

It has been concluded that the VDC secretary and social mobilizer must now adhere to their operating calendar, communication to the stakeholders, considerable committee expertise and a range of management skills that are traditionally not expected of them.

There is no any practice of sharing and publishing of SSE distribution in the village for public notice. Premchand (1999) stated that individual's actions are guided by an informal code of conduct. But it was not seemed in practice.

Conclusions

The aim of this study was to investigate the status of social security entitlement distribution and financial accountability of the VDC secretary. It explored the perception and practice of beneficiaries and the service delivery. The research concludes that the service delivery is poor and accountability in local bodies in Nepal is at lower level than desirable. The most challenging area is the level of capacity of the VDC secretary, social mobilizer, awareness of the people about the government service and mechanism regarding the SSE. And they not only need education but specific expertise as well. The disparity in the operation system for the public service needs attention.

It has been established that the roles of VDC secretary are and will remain a big question locally as well as nationally, as many questions are being posed around their functioning. In this context, some of the research participants like senior citizens also emphasized that the VDC secretary needs to be more accountable in
financial matter. Their financial management responsibilities, which are mainly related with, SSE fund with those different standards of SSE distribution, it can be argued that current financial accounting practices of the local bodies do not promote full and equal service delivery and financial practice. It can also be concluded that the practice that VDCs follow concerning accounting, recording and reporting are not exactly as prescribed by the law. It has transpired that these responsibilities demand certain measure of capacity from VDCs, which in reality appear to be meager. This raises questions on the quality of capacity building program in local level.

The study concluded that allocation of SSE in the budget i.e. budget allocation system is poor, no fiscal information is shared in the public. The government is the responsible body for the management of the government expenditure. Furthermore the VDC secretary practices the financial accountability in the local bodies although the components of SSE are practiced in VDC. There is poor implementation of framework/calendar and also there are gaps among the system, provision and execution in Nepal.

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How Fiduciary Risk can be minimized in Local Development Activities in Nepal: Some lessons from sub-national PEFA assessment result

- Subas Chandra Shiwakoti*

Abstract

It is widely accepted that local government unit performs as a closer government to people. It can play vital role to provide feelings of good governance to people from root level. For this, all local developmental and service delivery activities should perform in accountable and transparent way, where to promote fiscal accountability is one of them through minimizing fiduciary risk at all. Fiduciary risk is being a burning issue not only in the field of public expenditure; it is raising its concern up to global forum. In Nepal’s context, there are many attempts to improve the situation. Developing and implementing fiduciary risk reduction action plan (FRRAP) in local bodies’ level is one major intervention. To analyze the context of fiduciary risk at local government level in Nepal, it was assessed its public expenditure and financial accountability (PEFA). This paper has aimed to explore the problems facing in Nepal and how the fiduciary risk related problem can be overcome. It is also expected the need of sound financial management system in this transforming stage federalism for sub-national government and especially for grassroots’ level of government.

1. Background

Nepal is now in the stage of a major political, administrative and fiscal restructuring process as per newly promulgated Nepal’s Constitution based on federal and republic system. The constitution has created federal structured governance system with three level of power sharing between State, Province and Local Government. In this context, country is preparing itself for adopting the federal system from political, administrative, financial and other behavioral terms. For this, there are needed many transitioning and transforming activities to be performed like legal development, structural setup, human resource management,

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financial management, continuing public services, and so on. In this contest, considering all the constitutional and political commitments, country is now preparing for the transitioning and transforming reform plans & activities that provide a framework for performing governance activities in strengthening federal system and fostering equitable development benefits having good and prosperous governance to the citizens.

Public financial management (PFM) area is one major contributing area for the journey of good governance and prosperous nation building. In Nepal, there are three major characteristics of public financial activities. They are as follows:

- Central government's (CG) financial management practices,
- Local Government's (LG) financial management practices, and
- Public owned enterprises' (PEs) and autonomous bodies' financial management practices.

Ministry of Finance (MoF), Financial Comptroller General Office (FCGO), and other Line Ministries (LMs) are the main government agency responsible for that all types of public financial activities on behalf of Government of Nepal. Their responsibilities are to maintain both microeconomic and macroeconomic stability, facilitate development, provide public good & services in equitable way, and so on. For this, there is needed to allocate the public resources in rationale way, do better management of public expenditure as planned, foster the mobilization of all possible both internal and external resources in sustainable manner, increase performance in delivering public goods & services, and do implement the government's policies and regulation for achieving nation's objective and obligation as well. These types of financial activities are controlled under a financial act and regulation by central government. On the other hand, locally represented government units are managing many developmental and regulatory activities. Based on Local Self Governance Act (LSGA), 2055, the local bodies are almost separately managing local financial activities. It is not easy to say that there is separate or uniform financial management system in between central and local government. There is mixed practices up to now.

People are receiving public services from their near through local units. It is a milestone of success. Along these good things, there is a huge percentage of financial irregularities and unsettled financial issues. According to Office of
Auditor General (OAG) Nepal, almost 17% audit observation is remarked out of total financial transaction of LGs. The observation of OAG provides the demand of intervention to mitigate fiduciary risk issues at local government level.

1.1 Tools of observing fiduciary risk

Fiduciary risk is always associated with public resources. Therefore, its observing tools are also directly linked to public activities. There are many international practices and sub-sets of assessment dimensions as per the institutional needs like; fiduciary safeguards for minimizing corruption risks, OECD risk awareness tools, operational risk management, and different public financial management risk assessment frameworks (e.g. PEFA framework, PETS, etc.). Public entities can use any appropriate tools for their assessment purpose. Hence, Nepal has been used PEFA framework to do assessment twice (in 2008 and 2014) at national level, and once (in 2015-16) at sub-national level.

1.2 Need of PEFA assessment at national and sub-national level

There are many remarkable contributions of local government to provide public services to people in closer way. They are fostering socio-economic development and contributing to reduce poverty in every level (rural as well as urban area). There is a need to know the key success financial contributors that can be replicated and/or enhanced for better management. On the other-hand, there are questionable remark about proper use of public resources at local government level. For this, it is essential to take account of those financial issues that can be reformed and/or restated for mitigating the problems and rebuilding the sound financial management system.

In this regards, government has done the PEFA assessment at sub-national level to find out ground reality of financial management aspect. The assessment was expected to assist the government and its partners on these three areas:

a) Prioritize actions already identified in the Fiduciary Risk Reduction Action Plan (FRRAP) for local government;
b) Identify weaknesses in the legal and regulatory framework for PFM at the local government level, and
c) Assist in identifying issues of non-compliance in parts of the PFM system that may need further scrutiny and training.
Based on the above three areas, the assessment has done to identify possible interventions in improving budget planning, expenditure and revenue management and audit and accountability processes, and also to prioritize PFM reform areas like; fund flow and management, record keeping, and so on.

2. **Understanding of Fiduciary Risk and Public Expenditure and Financial Accountability (PEFA) Assessment**

2.1 **A short glimpse of fiduciary risk**

The associated risk for misusing public resources is known as fiduciary risk. In this concept, there may have these two possibilities:

a) The funds may not be used for the defined activities and/or purpose, and

b) The funds may not give the desired result.

Wherever these both (or one of them) possibilities occur(s), that is the situation of fiduciary risk. In Nepal's context, we can take these types of activities as fiduciary risk:

- not collecting revenue properly
- not coming the business in tax net
- not spending as per planning and budgeting
- done expenditure without set norms, without approving activities, for private purpose, etc.
- not for achieving desired developmental results
- not showing the statement to people and concern stakeholders
- not taking responsibility and accountability over the used public resources
- not taking decisions on time or taking decisions in wrong intention
- not following financial rules
- not providing information of used public fund
- not following participatory process in taking decision of the use of funds and in implementing/spending the funds
- corruption
Fiduciary risk will hamper to get positive & progressive development result, to establish responsible & transparent financial management system, and to promote good governance culture. For this, the situation of low risk of fiduciary can proof the well-functioning financial system (MoFALD, 2012). To ensure proper utilization of public resources, the public entities should develop proper internal control mechanism & system. That system may consist of legal, institutional, and ethical aspects. Then the result of fostering development, resolving conflict and root-outing corruption can be achieved through proper utilization of resources.

From this general overview, it can be realized that the overall component of PFM cycle (where budget process, expenditure management cycle especially on implementation, monitoring, auditing, etc.) should be systematized. The fiduciary risk may be critical in PFM system if there weak control systems, inadequate organizational capacities, incompetence human resources, inefficiency of management system and corruption. As per the FRRAP, 2012, fiduciary risks include three fundamental elements at macro level, which is show in figure 1.

**Figure 1: Components of Fiduciary Risks**

![Diagram showing Components of Fiduciary Risks]

*Source: (MoFALD, 2012 - PEFA-FRRAP, P.10)*

### 2.2 General Understanding of PEFA Assessment

There are many tools and frameworks for assuring the better utilization of public funds. Public expenditure and financial accountability (PEFA) is one of them. "PEFA is a tool for assessing the status of public financial management. A PEFA assessment provides a thorough, consistent and evidence-based analysis of PFM performance at a specific point in time. The PEFA methodology can be reapplied in successive assessments to track changes over time." (https://pefa.org)
After seeing this definition, it can be taken as a methodology which can be addressed to evaluate the overall performance of PFM. The result of that assessment will be to assure the desirable budget outcomes in aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery. According to PEFA secretariat's website, 546 assessments have been done in different countries where 300 assessment reports have been published publically. There is world widely accepted certain indicators to do this assessment of the PFM system, where is seven pillars, 31 specific indicators and 94 dimensions. This set of assessment framework is upgraded in 2016. Before this, there were 6 dimensions and 31 indicators. Nepal has done both national assessment and one sub-national assessment based on the previous framework.

The seven pillars of PFM performance in this framework are budget reliability, transparency of public finance, management of assets and liabilities, policy based fiscal strategy and budgeting, predictability and control in budget execution, accounting and reporting, and external scrutiny and audit. The benefit of those assessments is to know the fiscal health of government and identify the gaps for further improvement in PFM system.

3. Management issues of Local public finance

Nepal is now in the stage of a major political, administrative and fiscal restructuring process as per newly promulgated Nepal's Constitution based on federal and republic system. The constitution has created federal structured governance system with three level of power sharing between State, Province and Local Government. In this context, country is preparing itself for adopting the federal system from political, administrative, financial and other behavioral terms. For this, there are needed many transitioning and transforming activities to be performed like legal development, structural setup, human resource management, financial management, continuing public services, and so on. Still we have unilateral system of governance, mind set of actors, and overall institutional mechanisms. In this contest, considering all the constitutional and political commitments, country is now preparing for the transitioning and transforming reform plans & activities that provide a framework for performing governance activities in strengthening federal system and fostering equitable development benefits having good and prosperous governance to the citizens. Previously there were two tiers of government (central and local), where were 5 development
regions, 75 Districts and 217 Municipalities & 3157 Village Development Committees. After promulgating the current Nepal's constitution, there are three tiers of government (federal, province and local), where is set 7 provinces, 75 district councils and to be decided number of Municipalities & Village government. The local public finance system is being managed on the scenario.

Currently, it is managing under the provisions of Local Self Governance Act (LSGA), 1999, Local Self Governance Regulation (LSGR), 2000, and Local Bodies Financial Regulation (LBFAR), 2007. These act and regulations have provided financial rights and duties with wider autonomy and legal framework to the local bodies like local taxes, revenue sharing between the two layers of government. The local finance system is operating through their own financial structure. Right now, there is transforming the federal structure which is also demanding to set up of the local public finance system as per the federal visioning. In this regards, the management issues of local public finance is as follows:

- Set up the financial management structure in federal context
- Best way of establishment of province and local treasury management system
- Establishment of inter-linkage of financial management system of the three layered government in the principle of autonomy and coordination.
- Place the predictable local finance policy
- Keeping accounting properly
- Do the financial reporting on time
- Lack institutional capacity for managing local income and expenditure
- Proper use of public funds
- Proper planning and its implementation
- Raising the issues of the misuse of public funds and disappearing their receipts/funds
- Not maintaining compliance
- Strengthening the control systems internally and externally
- Financial prediction capacity (e.g. identifying fiscal gap, national standards of services, equalization of grant, etc.)
- Competency of human resources' capacity in financial management field
- Using appropriate technology in financial management
- Issue of transparency culture
• Issue of financial accountability
• Inter-governmental fiscal relation
• Development of sound financial management system for fostering local development, promoting good governance, and reducing poverty.

4. Key indications in sub-national PEFA assessment report 2016

The sub-national PEFA assessment has done in 2015-16, based on the past 3 year's financial information of local bodies. There were selected 10 District DDCs, 10 Municipalities (including Kathmandu Metro), and 30 VDCs out of 75 DDCs, 217 Municipalities and 3157 VDCs respectively.

The report has taken some encouraging areas of progress and success. They are as follows:

• Adopting the grant system tied in Minimum Condition and Performance Measure (MCPM)
• Producing annual budget and financial statements publicly
• Dissemination and discussion on external audit reports/audit observations
• Good effort of public access to key fiscal information
• Properly maintained payroll records
• Transparent and cost-effective procurement in involving community groups
• Participatory budget process and people's participation at all
• The credibility of local revenue budgets is better in some Sub National Government although there is room for considerable improvement.

The report has also carried some weaknesses that are directly affecting financial performance. They are as follows:

• Weak use of IT procurement process
• Weak liabilities management for staff welfare funds, which is mandatory.
• Not enough transparency in expenditure and revenue receipts
• Weak in transparent procurement function and procurement activities
• Increasing the volume of audit suggestions
• Not producing financial reporting on time
• Not giving sufficient financial information because of lack of proper account keeping
• Reconciliation is not done in many cases
• Poor use of IT application in managing financial system (e.g. uniform and complete accounting software)
• Limited number of staffs and lack of capacity of the human resources in many
• Not used multiyear budgeting
• No reliable cash forecasting and fund management practice (including resource predication)
• Problem of descriptions of expenditure and adopting standard chart of account
• Budget credibility both in terms of aggregate expenditure and composition is poor.
• Weak internal control system and not enough internal audit practice
• Miss-conceptualization on local funds (there is miss-concept on local leaders, bureaucrats and other institutions that the local fund can use for any purpose).
• Not so trusty financial accountability because of the absence of regular finance committee meeting
• Not giving the proper financial position in many cases (lack of the proper practice of consolidation of Income & Expenditure statements)
• Gap of linking planning and budgeting with national plan (this is both way problem)
• Using default method of procurement through user group rather than open competition (this culture is promoting another types of collusion and catering)
• The external audit situation at municipal and VDC level is not giving satisfactory result to proper financial management
• Lack of maintaining quality of work
• Delaying budget authorization, allocation and fund transfer/release.
• Increasing trend of advance and many of them are not settling properly
• Conflict of interest of decision maker and implementer, accounting person and internal audit person, selection of final auditor and his/her independent role (especially on Municipality and VDCs)

These are the key indication of Sub-national PEFA assessment result in Nepal. The assessment has scored the local bodies as per the set indicators and benchmark as per PEFA framework before 2016. **The summary of score is placed on annex 1.**

5. **The suggested way for resolving fiduciary risk in sub-national PEFA assessment report 2016**

To provide public services easily to people in closer way and to promote financial accountability of frontline government agencies (here in local government), there are many efforts by public sectors, development partners and people's own involvement in different ways. Implementation of fiduciary risk reduction action plan (FRRAP), national public financial management reform plan (PFMRP) and other result frameworks are contributing in strengthening downward accountability.

In this context, the assessment report has provided some suggestions. Among them, the fiduciary risk related suggestions are as follows:

5.1 **Improving the PFM Framework**

• The used PFM framework, set by LSGA, financial regulations (LBFAR 2007) and Local bodies' resource mobilization guideline need to update for addressing the requirements with modern PFM (for example no requirements for cash-flow forecasting or multi-year budgeting, and non-compliance of the Chart of Accounts with standard accounting and reporting frameworks).
The regulations themselves are silent or contain little detail on a number of important aspects of control (e.g. stores, archiving and storage of documents, maintenance of authorizations). These issues may be covered in other government financial regulations but should be contained in a single comprehensive set of regulations.

The requirements for VDCs are potentially onerous given their small level of resourcing and absence of financial staff and these should be substantially simplified in a revised framework.

5.2 Improving Compliance with basic financial control procedures

- Make monthly bank reconciliation particularly for operational accounts mandatory
- Improve the situation to maintain operational accounts regularly and up to date advance registers, ensuring that advances are promptly retired in accordance with the 35-day rule
- Improve the internal control system through;
  i) Specific allocations of duties to accounts and administration staff rather than reliance on generic job descriptions,
  ii) A more routine regular system of reporting on financial affairs to local management including when reconstituted accounts committees of locally elected representatives, and
  iii) An enhanced role for internal auditing which should include short monthly summaries on internal audit activities and proper trimester reporting

5.3 High Level management of resources:

- Take a clear policy in mobilizing and managing users' committee and people's participation
- Prepare more realistic annual and periodic plan
- Establish the linkage between nation plan, periodic plan and annual plan
- Prepare and use more sophisticated performance related frameworks (it will contribute to develop responsible local government)

5.4 Investment in financial management capacity:

- Need to investment in IT systems, focusing in the first instance on locally designed systems using open source code which can be adapted to the needs of the local environment.
- Develop a regular ongoing training program, rather than relying on ‘one-shot’ introductory training
• Conduct PFM specific and job related training regularly (e.g. many internal
  auditors have received no formal internal audit training at all)
• A sharper focus on allocation of specific roles and responsibilities will improve
  individual accountability of staff for PFM work

5.5 Reform of the Financial Framework (LSGA, LBFR)

• Cover the chart of account and make compatible with national and internal
  standards
• Cover the all regularization and internal control aspects
• Consider the Treasury Single Account (TSA) system at subnational level
  (i.e. local government level)
• Regularize the off-budget funds
• Make a compatible framework at all (e.g. reduce the number of guidelines
  and prepare compatible form and provisions for financial functions)
• Include in fostering financial management capacities

In this way, the report has suggested to resolve the fiduciary risk in local level's
financial functions.

6. Conclusion

It is not easy to say the ways of reducing fiduciary risk because those risks will be
associated with different dimensions and variety of perception as well as behavior
of person. It can be seen in all aspects and dimensions of PFM, and also at all
levels of government. Local government is known as frontline government who
will always be closer to people. Hence, the fiduciary risk related issues will
explore quickly in local government because of closeness of people. In perceiving
this, there is more important to minimize fiduciary risk at local government level.
To identify the issues on it, Nepal has done sub-national PEFA assessment. The
assessment has given some encouraging progress areas like MCPM grant system,
public access to key fiscal information, participatory budget process and people's
participation. These areas' lessons can be replicated in other sectors. The
assessment report has also suggested many reform areas in local public finance
management. The areas of improvement in PFM framework, financial
compliance, financial control procedure, management of resources/funds,
financial management capacity, and legal as well as institutional framework. The
assessment result has given broad ideas that how the further policies and actions
can be mainstreamed. Therefore, it is the time to implement the suggested
mitigation actions through legal reform and/or institutional reform and/or capacity development. It is also hoping that this transitional period of federalism can be used for making better local public financial management system having not fiduciary risk.

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Non-agriculture sector and economic growth in Nepal
- Dr. Sovit Lal Bajracharya*

Abstract
As an agrarian country the agricultural sector in Nepal should have been a major driving force for its development but agricultural productivity is not satisfactory. Hence, this paper has explored the importance of non-agricultural sector for the purpose and evaluated the same in context of Nepalese economy.

Keywords:
Agrarian country, Gross Domestic Product GDP, Service sector, Industrial sector

Introduction
Nepal is an agrarian country. Out of total population, 67.7 percent people are engaged in agriculture sector and this sector has contributed to total GDP by 34.33 percent. (Economic Survey, 2012/2013: 131). But agriculture sector has faced numerous problems such as irrigational facilities, transportation, topographical, rain-fed cultivation, dearth of modernization and commercialization, marketing etc. Of which, agricultural productivity is lower. So, to accelerate economic growth rate, industrialization and services or non-agriculture sector can play important role.

Youths are outsourced. They are the milestone of economic development of the country. So, to increase employment opportunities and control outsourcing of youths over foreign land and again to accelerating economic growth rate of the country, non-agriculture sector can be assumed as helping hands.

The expansion of economic activities lies in the development of industries of any country. The agriculture sector alone cannot provide employment opportunities as

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well as the fulfillment of basic needs to the growing population of the country. Therefore there is a need to enhance the industrial sector parallel to agriculture and other sectors of the economy. Industrialization seems to be inevitable for rapid economic growth, self-sufficiency and import substitution, higher employment and income opportunities, utilization of natural resources, correction of unfavorable balance of trade, skill development and so on. In spite of worth of industrialization, it has been facing challenges such as financial problems, shortages of raw materials, intermediary exploitation, government support, primitive technology, lack of infrastructure, defective industrial policy, landlocked position, industrial finance, quality product, load shedding, industry unfriendly labor, political instability and so on.

Non-agriculture sector refers to industrial and service sectors. Services sector also includes many activities not included before - like microbus cable car services under transportation; PCO, mobile telephone, internet, cable television communication, renting, services of employment agencies, cooperatives, consultancies, computer and photography, private postal services, private sector education services, community forest and others.

Increment of gross domestic product (GDP) of the country perpetually sounds as economic growth. Low economic growth is a core obstacle of economic development. So these two variables are concomitant with one another. The term economic development is used interchangeably with such terms as economic growth, economic welfare, economic progress and secular change. Economic growth means more output, while economic development implies both more output and changes in the technical and institutional arrangements by which it is produced and distributed. (Kindleberger, 1976:3)

According to Madison “The raising of income levels is generally called economic growth in rich countries and in poor ones it is called economic development.” (Madison, 1970) Economic growth is measurable and objective. It prescribes expansion in the labor force, in capital, in the volume of trade and consumption. And economic development can be used to describe the underlying determinants of economic growth such as changes in techniques of production, social attitudes and institutions. Such changes may produce economic growth.
Literature Review

Kindleberger and Herrick (1977) describes that the differences between growth models and development models can be inferred from the differences in the processes of growth and development themselves. Variegated composition of the economy, the differences in sectored responses and the reactions of individuals within a setting of poverty are neglected or ignored by growth models, but they are at the heart of models of economic development.

Rawaski, Thomas G. (1979) explains that emphasis placed by China on labor force – intensive methods of raising agricultural output, supported by its rural industry’s program and the resulting effects on the regional dispersion of industry provide valuable insight, both for countries that have not opted for this as one of the elements of an employment and growth policy and for others that have or are in the throes of doing so. Even if China’s political, social and economic system is radically different; there are many examples of how knowledge of its experience can enrich the understanding of those concerned with employment policy elsewhere.

Colander (1993) states that the USA economy exhibited growing or expanding trend. Economists use changes in real gross domestic product (real GDP) – the market value of final goods and services produced in an economy, stated in the prices of given year – as the primary measurement of growth when produce and sell their goods, they earn income, so when an economy is growing, both total output and total income are increasing. Such growth gives most people more this year than they had last year. Since most of us prefer more to less, growth is easy to take.

Rudiger, D. B. and et.al, (2006) delineates that economic growth is due to growth in inputs, such as labor and capital and to improvements in technology; capital accumulates through saving and investment. The long run level of output per person depends positively on the rate of population grow. The neoclassical growth model suggests that the standard of living in poor countries will eventually converge to the level in wealthy countries.
Objectives of the study

The basic objectives have been set as given below:

(i) To examine the status of economic growth of Nepal.
(ii) To assess non-agriculture sector and economic growth of Nepal.

Methodology and Data Source

Descriptive Cum survey method is employed here to analyze non-agriculture sector and economic growths of Nepal.

Statistical Interpretation

So as to show relationships amongst economic variables such as economic growth, agriculture, industrial and services sectors, some statistical tools like Chi-square test, Correlation, the coefficient of multiple determinations and the adjusted coefficient of determination have been employed.

Measurement of Economic growth

Measuring of economic growth supports to the planner to identify and ascertain strategy to be footed for further steps. One can directly compute the growth rate by using the formula:

\[ GN_t = GNP_b (1 + r)^n \]  \hspace{1cm} (1)

Where \( t \) designates the terminal year, \( b \) the beginning year of the period, \( n \) the number of years in the period and \( r \) the average annual rate to be determined. Solve by converting the equation to logarithms:

\[ \log (1+r) = \frac{\log GNP_t - \log GNP_b}{n} \]  \hspace{1cm} (2)

The average annual growth rate may be determined from a compound interest table by finding the interest rate required to produce the percentage change in the indicated time period. Economic growth should be deflated from interest rate or inflation rate to compute real economic growth.
Determinants of economic growth in developing countries

Institutional quality – as measured by bureaucratic efficiency, absence of corruption, protection of property rights and the rule of law – is important for economic growth. So are political stability and civil and economic liabilities. Especially important are protection of property rights, a capable and honest bureaucracy and political stability, particularly if initial conditions are favorable for economic take off. There should be assistance to the poor countries so as to make betterment of institutional performance. Only countries that show progress in institution building should receive assistance, in turn it helps to augment economic growth.

Constraints of economic growth in developing countries

Constraints of economic growth can also be resumed as the marrows of developing countries to day. In ability to form human capital is a core obstruction of economic growth. Vicious circle of poverty, imperfection of market, low capital formation, rapid population growth, lack of infrastructure, lack of foreign capital, adverse effects of international forces, backward agriculture, lack of entrepreneurship and management talent, socio-cultural obstacles, lack of scientific and technical knowledge are also the problems and constraints of economic growth for developing countries.

Economic growth of Nepal

Economic and social development activities of Nepal are being carried out with objectives of reducing poverty by achieving broader and sustainable economic growth, bringing desirable change in life style of entire Nepalese by adopting inclusive development progress and laying foundation to transform Nepal in to a prosperous Nepal.

Economic growth and poverty are interrelated. Generally, economic development is believed to reduce poverty. Over the last fifteen years, poverty has remarkably come down in spite of lower economic growth meaning that reducing poverty would be much easier if economic growth rate could be increased. Higher economic growth can never be attained unless production and productivity rise. For current fiscal year, it is estimated to grow economic growth by 3.56 percent. A number of factors like ever extending political instability, problems in industrial environment, low private sector investment, energy crisis, lower credit
expansion of banks have restricted the growth of industrial production resulted in sluggish economic activities of the non-agriculture sector, thereby restricting this sector growth to 4.98 percent. Growth rate of agriculture also stood at 1.26 percent with decline in production of food grains due to absence of timely monsoon rainfall and insufficient rainfall in the winter. The status of economic growth of Nepal has been shown sector wise in table below as:

Table: 1

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Industry</th>
<th>Service</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/04</td>
<td>1.5</td>
<td>6.8</td>
<td>4.4</td>
</tr>
<tr>
<td>2004/05</td>
<td>2.9</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>2005/06</td>
<td>4.4</td>
<td>5.6</td>
<td>3.7</td>
</tr>
<tr>
<td>2006/07</td>
<td>4</td>
<td>4.5</td>
<td>2.8</td>
</tr>
<tr>
<td>2007/08</td>
<td>1.6</td>
<td>7.3</td>
<td>5.8</td>
</tr>
<tr>
<td>2008/09</td>
<td>-0.6</td>
<td>6</td>
<td>3.9</td>
</tr>
<tr>
<td>2009/10</td>
<td>4</td>
<td>5.8</td>
<td>4.3</td>
</tr>
<tr>
<td>2010/11</td>
<td>4.4</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>2011/12</td>
<td>3</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>2012/13</td>
<td>1.5</td>
<td>6</td>
<td>3.6</td>
</tr>
<tr>
<td>Average</td>
<td>2.7</td>
<td>5.3</td>
<td>4</td>
</tr>
</tbody>
</table>


Table 1 depicts that preceding decade was not encouraging for Nepal in terms of economic growth. Except for achieving 5.8 percent economic growth in F/Y 2007/08, growth rate in other years remained got limited either to 4 percent or close to it. In fiscal year 2006/07, growth rate stagnated to 2.8 percent. As such the country could achieve the average economic growth rate 4 percent in the last ten years. During this period, sector wise growth was also not encouraging. Average growth rates of industry and services sectors also stood at 2.07 percent and 5.3 percent respectively.

The relationship between Industry and total economic growth of Nepal or contribution of industry to total economic growth can be shown by the help of table as given below:
Table: 2

Contribution of industry to total economic growth

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Industry</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/04</td>
<td>1.5</td>
<td>4.4</td>
</tr>
<tr>
<td>2004/05</td>
<td>2.9</td>
<td>3.2</td>
</tr>
<tr>
<td>2005/06</td>
<td>4.4</td>
<td>3.7</td>
</tr>
<tr>
<td>2006/07</td>
<td>4</td>
<td>2.8</td>
</tr>
<tr>
<td>2007/08</td>
<td>1.6</td>
<td>5.8</td>
</tr>
<tr>
<td>2008/09</td>
<td>-0.6</td>
<td>3.9</td>
</tr>
<tr>
<td>2009/010</td>
<td>4</td>
<td>4.3</td>
</tr>
<tr>
<td>2010/011</td>
<td>4.4</td>
<td>3.8</td>
</tr>
<tr>
<td>2011/012</td>
<td>3</td>
<td>4.5</td>
</tr>
<tr>
<td>2012/013</td>
<td>1.5</td>
<td>3.6</td>
</tr>
</tbody>
</table>

The Table 2 shows contribution of industry to total economic growth for different years. Here, industrial contribution is regarded as independent variable and total economic growth as dependent variable. In order to show the relationship between contribution of industry($x_1$) and total economic growth($y$) a regression of the form 3 has been fitted and estimated.

\[ Y = a_1 + b_1x_1 \quad \ldots \ldots \quad (3) \]

From this equation we can compute the value of the regression coefficient ‘$b_1$’ using the formula

\[ b_1x_1y = \frac{\sum x_1y}{\sum y^2} \quad \ldots \ldots \quad (4) \]

We can find the value of regression coefficient ‘$b_1$’ by calculating $\sum x_1y$ and $\sum y^2$ and dividing the former by later. Here $b_1x_1y=0.302$. $R$ square = 0.532, Adjusted $R$ square = 0.474, standard error of the estimate = 0.5983 and $F = 0.803$. As the value of F- static is very low it appears that there is insignificant contribution of industrial sector in total economic growth of Nepal. Thus it clarifies the insignificant contribution of industrial sector in total economic growth of Nepal.
The relationship between service and total economic growth of Nepal or contribution of service sector to total economic growth can be shown by the help of table as given below:

**Table: 3**

**Contribution of Service to Total Economic Growth**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Service</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003/04</td>
<td>6.8</td>
<td>4.4</td>
</tr>
<tr>
<td>2004/05</td>
<td>3.3</td>
<td>3.2</td>
</tr>
<tr>
<td>2005/06</td>
<td>5.6</td>
<td>3.7</td>
</tr>
<tr>
<td>2006/07</td>
<td>4.5</td>
<td>2.8</td>
</tr>
<tr>
<td>2007/08</td>
<td>7.3</td>
<td>5.8</td>
</tr>
<tr>
<td>2008/09</td>
<td>6</td>
<td>3.9</td>
</tr>
<tr>
<td>2009/10</td>
<td>5.8</td>
<td>4.3</td>
</tr>
<tr>
<td>2010/11</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>2011/12</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>2012/13</td>
<td>1.56</td>
<td>3.6</td>
</tr>
</tbody>
</table>

The Table 3 shows contribution of service to total economic growth for different years. Here, service sector contribution is regarded as independent variable and total economic growth as dependent variable. In order to show the relationship between contribution of service and total economic growth following equation has been used

\[ b_{xy} = \frac{\sum xy}{\sum y^2} \]

We can find the value of regression coefficient by calculating \( \sum xy \) and \( \sum y^2 \) and dividing the former by later. Here \( b_{xy} = 0.643 \), \( R^2 = 0.413 \), Adjusted \( R^2 = 0.340 \), standard error of the estimate = 0.6701 and \( F = 0.803 \) Thus it clarifies the significant contribution of service sector in total economic growth.

**Conclusion**

- For current fiscal year 2012/013 it is estimated to grow economic growth by 3.56 percent. A number of factors like ever extending political instability, problems in industrial environment, low private sector investment, energy...
crisis, lower credit expansion of banks have restricted the growth of industrial production resulted in sluggish economic activities of the non-agriculture sector, thereby restricting this sector growth to 4.98 percent.

- Preceding decade was not encouraging for Nepal in terms of economic growth. Except for achieving 5.8 percent economic growth in F/Y 2007/08, growth rate in other years remained got limited either to 4 percent or close to it.

- Contribution of industrial sector to total economic growth of Nepal in 2003/04, 2011/012 was estimated to be 1.5 percent and 2.9 respectively. In 2012/13, it reached to 1.5 percent.

- Contribution of service sector to total economic growth of Nepal in 2003/04, 2011/012 was estimated to be 6.8 percent and 4.5 respectively. In 2012/13, it reached to 1.56 percent.

Bibliography:


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Abstract

The article has presented analyses from the text of the Constitution on sub-national public financial management provision.

Background

When listening to public debates in Nepal about the Constitution these days, one may be surprised by how people seem to think that all options are still open and how little consensus there is about what the new federal democratic republic of Nepal will look like when the Constitution is implemented. This is surprising, because the Constitution of Nepal 2015 is a 241 page document (in the official English version) that is pretty explicit and quite precise about a whole range of issues, even if the details are left for subsequent laws and regulations. Broadly speaking, there are two main options: either the Constitution will be implemented as it has been voted and in this case Nepal has a clear (which does not mean easy) roadmap for the years to come or resistance mechanisms at political and administrative levels will obscure the process, deviate it from the intention of the Constituents and will finally make the constitutional process fail or produce minimal changes. These brief remarks are considering only the first option and are trying to provide analysis, as close as possible from the text of the Constitution, of the consequences for Public Financial Management (PFM), i.e. budgeting, cash management, tax administration, expenditure management, financial reporting, and controls and audits, of the implementation of the new Constitution.

The Constitution defines Nepal as a federal democratic republic with a State organized, under the principle of “national unity”, (Part 4-51-a-1), around three levels: federal, State and local, which should all protect the national interests and

* Manager, Nepal PFM MDTF, World Bank.
principles. The local level is comprised of villages\(^+\) and municipalities. Each level has the power to vote laws for matters under their mandate which are enumerated in various schedules annexed to the Constitution. There are clearly identified concurrent powers (like Health for instance which is a shared responsibility of all three levels) and powers which are not explicitly attributed are reputed of a federal nature. Each level has an assembly and an executive, the authority to levy taxes, vote a budget and exert what the Constitution calls their “financial powers”. The district, which was the center of the administrative structure and local political life, does not disappear but will have only a role of coordination and balance among the various levels of administration present in the district through a district assembly (Part 17-220). The district does not have legal and financial powers. Contrary to villages and municipalities which have quite a history in Nepal and can build on existing, even if sometimes sketchy, administrative and political apparatus, the State, i.e. the federated State as opposed to the federal State, is a new structure comprised of a number of districts defined in a schedule annexed to the Constitution.

It is therefore pretty clear, when we compare the Constitution with the current organization of Nepal, that what is needed is a deep and wide reengineering of the State, including in terms of flows of public money. It involves the creation of a new structure at the State level (there are seven of them), the strengthening of municipal and village levels in terms of administrative capacity but also in terms of local democracy and, which is usually less recognized, a drastic adaptation if not a redefinition of the mandate and capacities of key central ministries and agencies.

This State reengineering involves a lot of aspects, including for instance in terms of civil service reform, but the following remarks will focus only on budgetary and financial aspects, i.e. PFM.

1. Revenue mobilization and collection

In broad terms, sub-national entities can rely on three sources of revenue: tax, loans or transfers from higher levels of government. In some cases, they could receive grants from external partners. In the current situation, transfers from

\(^+\) A village in the political and administrative sense is in fact a grouping of several villages (up to 10 or 15)
central government constitute around 80% of municipal and village development committee (VDC) revenues.

The new Constitution will not drastically change this revenue structure. Schedules 5 to 8 annexed to the Constitution define and limit the list of taxes that each level will be authorized to levy. It appears first that the main revenue producing taxes (customs, VAT, corporate and individual income tax etc.) will remain under the control of the federal State and that the lower levels, including the federated State level, will have to be content with taxes that are not likely to generate substantial income and in addition appear to be under the concurrent control of federated States and local levels (house and land registration or vehicle tax for instance). Besides, the taxing power of local level is restricted since it can only be exerted “without prejudice to national economic policies, carriage of goods and services, capital and labor market, and the neighboring State or Local level” (Part 19-228).

The provincial State does not appear to have such limitation. Of course, State and local levels should make the most of this taxation powers and available analytical studies show that there is ample room for improvement in the performance of local tax collection and this a route that needs to be explored. Nevertheless, it is likely that local tax collection will not be the main source of funding for sub-national governments in the foreseeable future.

The Constitution does not prevent local governments from borrowing, which is already possible in principle but has rarely been used, except for a few municipalities. It is difficult to see how this would change in the short term and it is probably not advisable at this stage, except cautiously for a few big municipalities. States will have the right to take loans, but “no loan shall be raised and guarantee given by the State Government except as provided for in the Federal law”. This control mechanism is pretty weak, unless federal law makes mandatory an approval of the federal minister of finance for any federated State borrowing. In fact, the overall fiscal balance of the country is clearly under the responsibility of the federal State and the sub-national borrowing would have to be submitted to the fiscal rules and debt sustainability objectives adopted by central government: Provisions relating to the management of budget deficits and other fiscal discipline of the Federation, State and Local level shall be as provided for in the Federal law. (Part 16-59 (7)) Even if debt sustainability is not yet a major issue in Nepal, it is likely that the necessities of fiscal discipline will prevent borrowing from being a major funding source for the federal level. This
being said, targeted borrowing in support of credible and priority investments should be a possible option for provincial States, discussed jointly with the NRB and central government.

In view of the above, it seems quite obvious that fiscal transfers from central government will be the major source of funding for States and local levels. The Constitution actually elaborates a bit on this. The following principles are laid out:

- Revenue distribution should be “equitable” between the three levels and “transparent” and obey a number of principles like service delivery, capacity of entities to generate revenue, development plans, poverty, feasibility of projects or temporary needs;
- The amount of fiscal transfers should be as “recommended” by the National Natural Resources and Fiscal Commission;
- “The Government of Nepal shall, on the basis of the need of expenditure and revenue capacity, distribute fiscal equalization grants to the State and Local level.” Provincial States should also provide fiscal equalization grants to the local levels under the same principles. Other grants will be provided by central government;
- Benefits from natural resources will have to be equitably distributed between the three levels;*

Three remarks in conclusion. First, it is likely that central government would have to increase substantially the amount of transfers to lower levels in order for these sub-national entities to be able to fulfill their mandate. This will require, in order for these transfers to be productive, equitable and transparent, a substantial effort from central government agencies, in particular the ministry of finance, to generate adequate information about sub-national funding needs, performance in revenue collection and budget implementation. The MoF does not currently have the systems and mechanisms in place to

* See in particular the following mentions: “(4) The Federation, State and Local level shall provide for the equitable distribution of benefits derived from the use of natural resources or development. Certain portions of such benefits shall be distributed, pursuant to law, in forms of royalty, services or goods to the project affected regions and local communities. (5) If, in utilizing natural resources, the local community desires to make investment therein, the Federation, State and Local level shall accord priority to such investment in such portion as provided by law on the basis of the nature and size of such investment.” (Part 5-59)
make critical decisions in this area in an informed and technically sound fashion.

Second, the fact that sub-national governments will be mainly funded through central government transfers might question their capacity to manage themselves in an autonomous fashion. The Nepali citizen, who is a federal taxpayer, has the right to hold the federal government accountable for the transfers to sub-national levels but as a State and local taxpayer, he/she wants State and local levels to provide for services defined at these levels. Therefore, transfers from central government would need to prioritize unconditional grants and allow for discretionary use of funding generally as well as prioritize ex-post audits and controls instead of ex-ante controls in the expenditure cycle.

Third, it has to be noted that the Constitution envisages the possibility of performance-based criteria for intergovernmental fiscal transfers, whether these criteria are linked to financial management performance, i.e. capacity to mobilize local revenue or capacity to execute the budget and especially the capital budget, or linked to service delivery performance.

2. Budgeting

States and local assemblies will vote a budget presented by the finance minister of the State or the village and municipal executive and including an estimate of revenues and expenditures. The Constitution does not mention a particular calendar for the submission and vote of these budgets but it is obvious that the State and local laws that will govern the various budgetary processes would have to be coordinated in order to ensure that when sub-national budgets are voted, there is sufficient knowledge about the transferred amounts from central government and, in the case of local governments, from States. The possibility to present supplementary estimates at the State level will help but the credibility of the initial budget is important.

Local governments and States can present a budget where expenditures exceed revenues. In the case of villages and municipality, if the budget is in deficit, sources to meet the deficit also have to be presented.

It has to be noted that the annual State budget proposal needs to be accompanied by a statement of “whether the objectives of the expenses of
previous years have been achieved”. This constitutional requirement, while not elaborated upon, could be a powerful way to promote a performance-based budgeting process at the sub-national level.

3. Cash and expenditure management

Federal, State and local governments will operate for all expenditures and all revenues through their respective consolidated fund. Though it is not explicitly mentioned, this fund would probably have to be open at the NRB. What the Constitution does not specify is whether these various consolidated funds (several hundred) would be connected with the federal consolidated fund and function as a single system. This option is used in several countries, including advanced ones, and allows for a more efficient and less costly management of cash without hindering the independence of the three budget processes and the responsibility of the sub-national executives. The authorization to spend against the voted budget would still remain with the sub-national executive and the optimization of cash management at the central level would in fact increase the likelihood of expenditures being met and decrease the likelihood of having to find short term financing resources, often costly and difficult to manage.

The future of the central government network of Treasury offices (DTCO) is often discussed in relation with the new Constitution. Various options are possible but it is clear that central government will still have to implement its budget through expenditures made at the district and local levels and will still use its DTCO network to manage revenue collection and expenditure locally. In theory, State and local governments would have the option to create their own Treasury functions and offices which would be obviously costly and complex. The Nepal Treasury system was developed across decades of trials and errors and, especially in the last period, through substantial investments to achieve today a reasonable level of professionalism and controls over public moneys. Instead of developing across the country multiple parallel systems, one solution would be to optimize the use of the FCGO network of offices and their already advanced IT systems and propose that these systems support also revenue and expenditure management at State and local levels, on a contractual basis and against the payment of fees to the federal government. This would be a cost efficient solution.
4. **Controls and financial reporting**

State and local governments have to be accountable to their citizens above all but also to the higher levels of government that fund them. Again, a local citizen or taxpayer is always at the same time a citizen of the provincial State and of the Republic. Accountability mechanisms are necessarily intertwined. The Constitution is eloquently silent in terms of controls, financial reporting obligations and accountability mechanisms. It is assumed that specific laws at their respective levels will have to fill this vacuum. What international experience in decentralization tells us, including in developed countries, is that the risk of mismanagement of funds, inefficiencies and corruption is increased until adequate accountability mechanisms are in place. This should be a serious concern for Nepali decision makers and parliamentarians and receive attention when drafting the new laws and regulations in this area.

5. **External audits**

The drafters of the new Constitution have substantially increased the powers of the Auditor General Office (OAG) with just a few words: “The accounts of all Federal and State Government Offices including the Office of the President, Office of the Vice-President, Supreme Court, Federal Parliament, State Assembly, State Government, Local level, Constitutional Bodies and Offices thereof, Courts, Office of the Attorney General, Nepal Army, Nepal Police and Armed Police Force, Nepal shall be audited by the Auditor-General in accordance with law, having regard to, inter alia, the regularity, economy, efficiency, effectiveness and the propriety thereof.” The OAG will have to audit provincial States and local executives, which is a new function that will require a substantial reorganization and capacity building effort. The OAG is willing to open several branches across the country to support audit of sub-national entities. This evolution is crucial to fill the gap in the accountability framework at sub-national level and to mitigate the risks usually associated with federalism and decentralization.

6. **Short term priorities**

- Strengthen the capacity of central government ministries and agencies to cope with the changes involved in the new Constitution. The MoFALD*

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* Ministry of Federal Affairs and Local Development
for instance needs to redefine its functions and evolve from a managing role to an advisory and support role towards local governments. The MoF also will need to strengthen its capacity to design and manage a viable and sustainable intergovernmental fiscal transfer system supported by relevant financial reporting mechanisms and including a natural resource sharing framework.

- Define a strategy for the development of financial management functions at the sub-national level in a cost-efficient manner and relying as much as possible on existing systems. Federal government according to the Constitution should define norms, standards, general principles to be observed across the country in terms of financial management, including procurement and establish budget classifications, reporting formats and standards and so on. “The responsibility for issuing general directives, controlling and regulating the governance of Nepal shall, subject to this Constitution and law, lie in the Council of Ministers.” (part 7-75-2)

- Define a capacity support action plan for developing State and local governments’ functions.

- Define a comprehensive support envelop, including support from external partners, that help fund the technical capacity building necessary to implement the Constitution in terms of PFM and administrative reform. The support should be aligned with government priorities and coordinated between partners.

**Bibliography:**


http://mdtfpfm.org.np
Abstract

Public financial management (PFM) is an essential part of the development process. The broad objectives of public financial management are to achieve overall fiscal discipline, allocation of resources to priority needs, and efficient and effective allocation of public services. PEFA program provides a framework for assessing and reporting on the strengths and weaknesses of public financial management (PFM) using quantitative indicators to measure performance. Hence the paper has tried to elucidate the same for six critical dimensions of a PFM system with two important elements in general and in Nepalese perspective.

Keywords:
Public Expenditure and Financial Accountability (PEFA), Public financial management (PFM), Public Revenue, Economic Stabilization

1. Concept of Public Finance

Public Finance is the integration of two words Public and Finance. Public Finance is the field of economics that concerned with, how governments raise money, how that money is spent, and the effects of these activities on the economy and on society (Philip E Taylor, 1957, P.3). According to Jonathan Gruber Public Finance is the study of the role of the government in the economy. Thus, the effect of public finance can be seen in economic activity of any government. In addition, Public Finance is concerned with income & expenditure of public authorities and with the adjustment of one with the other. (Hugh Dalton, 1922. p3). Public finance is the collection of taxes from those who benefit from the provision of public goods by the government, and the use of those tax funds toward production and distribution of the public goods. Public Finance deals with

* Ms Karkee is the Accounts Officer in Government of Nepal and M Phil Scholar in CDPA, TU.
the way in which the State acquires and expends its means of subsistence. It stands in somewhat the same relation to the State that Political Economy stands to the individual (CARL C. PLEHN, 1902, p. 1). So, Public Finance is a branch of economics, which deals with the revenue and expenditure patterns of the government and their various effects on the economy (J Smith). It can be explained that it is the aggregate of economic relationships arising from the creation and use of centralized and decentralized monetary resources in B.G. Boldyrev words. Spending public finance is only half the picture. The ways in which public finance is raised also has to be considered. Most public finance is raised from taxes and revenues have generally been less than expenditures (Bailey 2004).

2. Scope and nature of Public Finance

Scope of Public Finance

The scope of Public Finance is logically concerned with the operations of the Public Treasury. Professor Richard A. Musgrave argued in his book 'The Theory of Public Finance: A study in Public Economy' (Musgrave, 1959, p xvii ) there are three major fiscal or budgetary functions of the governments. a) Allocation functions b) Distribution functions and c) Stabilization functions. According to him those are the branches of Public Finance.

1.1 The Allocation branch

There are certain cases in which the wants of all individuals cannot be satisfied through market mechanism. In such cases the public sector or the governments have to provide goods and services. The allocation branch of public finance deals with the provision of social goods. Social goods are those goods and services produced to satisfy collective wants. Collective wants are those wants that are demanded by all members of the community in equal or more or less equal amounts. The allocation branch explains the process by which the resources in use are divided between private goods and social goods by which the mix of social good is chosen.
2.2 The Distributive branch

The very important feature of a market economy is the disparity in the distribution of income and wealth. The distribution function of public finance deals with the adjustment of the distribution of wealth and income to ensure “fair or just” state of distribution. That is, the distribution function of public finance deals with the determination of taxes and transfer payments policies of the governments.

2.3 The Stabilization branch

The stabilization function explains the macroeconomic aspect of budgetary policy. In other words, the stabilization function deals with the use of budgetary policy as a means of maintaining high employment, a reasonable degree of price stability and an appropriate rate of economic growth, with allowances for effects on trade and balance of payments. The major instruments of stabilization policy are monetary policy and fiscal policy. This function is otherwise known as compensatory finance. Hugh Dalton (1922) has classified the various components of public finance as: (a) Public Revenue (b) Public Expenditure (c) Public Debt (d) Financial Administration and (e) Economics stabilization

2.3.1 Public Revenue

Public Revenue refers to the income of the states. According to the School of Management Science, it deals with the various sources through which Government generates funds to finance its activities. Such sources include taxation, borrowing, fines, fees, and income from public undertakings, rent and royalties. It also deals with the comparative advantages and disadvantages of each of these sources of revenue (PAD 2009, p. 15).

2.3.2 Public Expenditure

Public expenditure means the expenditure incurred by the government for various activities related to the public welfare and the society. According to H. C. Adams, public expenditure has to perform the functions of 1) Protective functions - Military, Police, Court and Protection against social diseases (2) Commercial Functions - Setting of commercial establishments under state control (Public sector undertakings) and (3) Development functions
- Education, Public Recreation, Maintaining equitable conditions for the execution of public business, Public investigation and Infrastructure development like public works, irrigation, forestry etc. Public expenditure, hence, signifies the expenditure incurred by public authorities i.e. Central Government, State Governments and local body for the satisfaction of collective needs of the citizens or for the promotion of economic and social welfare (U. K. Hicks 1968, P. 14).

2.3.3 Public Debt

This part of public finance studies the problem of raising loans. It further examines the problem of raising and repayment of loans along with interest. Public debt administration is also important as improper administration of which may land a nation in debt-trap.

2.3.4 Financial Administration

It deals with the problem of organization and administration of the financial mechanism of the government. The fiscal or financial administration is concerned with the government machinery which is responsible for performing various functions of the state. The budget is the master financial plan of the government. Government budget is the key that monitors the financial administration. It deals with the methods of Budget preparation, various types of Budgets, war Finance, Development Finance etc. Thus, financial administration refers to the mechanism by which the financial functions are carried on. In other words, financial administration studies the organizing and disbursing of the finances of the State.

2.3.5 Economic Stabilization

Economic stabilization as well as growth is the two aspects that have gained ground recently in the discussion of public finance. This part describes the various economic policies and other measures of the government to bring about economic stability in the country.
3. Public Financial Management

Financial Management is the important tool that helps the public sector getting money, spending money and reporting on money that means it directs how to allocate the resources, how to control and reports them in a systematic way (Andrew Graham, 2011, p1). Public financial management (PFM) is an essential part of the development process. The broad objectives of public financial management are to achieve overall fiscal discipline, allocation of resources to priority needs, and efficient and effective allocation of public services. Public financial management includes all phases of the budget cycle, including the preparation of the budget, internal control and audit, procurement, monitoring and reporting arrangements, and external audit (INTRODUCTION TO PUBLIC FINANCE PAD 209, p. 7). Financial Management helps the Public sector collect money, allocate money, spend money, weigh the costs and benefits of certain programs, account for money, report on how money was spent, and plan for the long-term. Public financial management is a system adopted by government in an attempt to plan, utilize, control and scrutiny the incoming and outgoing of public funds and their management. It assists strengthening governance, optimizing outputs from resources and ensuring inclusive and broad based development. PFM encourages not only the national sources to promote the funding activities for the country’s economy but also encourages the donor parties to take several initiatives to strengthen it. Effective Public Financial Management (PFM) systems are required to maximize the efficient use of resources, create the highest level of transparency and accountability in government finances and to ensure long-term economic success (Overseas Development Institute: ODI 2005).

Importance of Public Financial Management

The effective management of public finances known as public financial management (PFM) which is fundamental to the development and growth of government economies. Governments are responsible to their citizens for implementing effective systems of public financial management and for utilizing those systems to safeguard, and ultimately enhance, a country’s economic sovereignty. (Confederation of Asian and Pacific Accountants - CAPA 2013, P 6) One of the main reasons of needs of public financial management is that the public or tax-paying citizens of any government expect their public finances to be well-managed, effectively allocated, used to deliver quality services, and to
provide a secure and stable environment in which society may exist and prosper. The importance of PFM is increasing rapidly because Public financial management is critical to improving the quality of public service outcomes. It affects how funding is used to address national and local priorities, the availability of resources for investment and the cost-effectiveness of public services (Association of Chartered Certified Accountants: ACCA).

In addition, effective public financial management is important for decision-making. Accurate financial information is used as the mechanism to support decisions and ensure effective resource allocations.

4. PEFA: Framework for assessing PFM

PEFA program provides a framework for assessing and reporting on the strengths and weaknesses of public financial management (PFM) using quantitative indicators to measure performance (PEFA Framework, World Bank, 2016, p.3). PEFA is designed to provide a snapshot of PFM performance at specific points in time using a methodology that can replicate in successive assessments, giving a summary of changes over time. The PEFA framework includes a report that provides an assessment of the implications for overall system performance and desirable public financial management outcomes. It provides a foundation for reform planning, dialogue on strategy and priorities, and progress monitoring (PEFA Framework, World Bank, 2016, p.4).

Public Expenditure and Financial Accountability (PEFA) refers an assessment tool along with integrated framework. It is the program initially sponsored by The World Bank, The International Monetary Fund, The European Commission, and The United Kingdom’s Department for International Development, The French Ministry of Foreign Affairs, The Royal Norwegian Ministry of Foreign Affairs, and The Swiss State Secretariat for Economic Affairs, and The Strategic Partnership with Africa. The main objective of this program is to enhance financial transparency and accountability of public expenditure. PEFA has the core objective to enhance expenditure management and reduce associated fiduciary risk through strengthening systems, processes and institutions (PEFA Handbook, 2010, p.3).

The purpose of a good PFM system is to ensure that the policies of governments are implemented as intended and achieve their objectives.
5. How to measure the PFM performance

The PEFA framework measure the PFM performance under six critical dimensions of a PFM system: those are Credibility of the budget, Comprehensiveness and transparency, Policy-based budgeting, Predictability and control in budget, Accounting, recording and External scrutiny and audit (PEFA guidelines 2005, p. 5). The framework includes two important elements:

A set of high-level indicators: The set of indicators identifies key elements in the PFM and also measures the operational performance of the PFM system, processes and institutions of a country and The PFM performance report is prepared on the basis of the result of PFM performance based on the indicators. The indicators include several elements that help in the measurement of the PFM performance but the countries using it can also include any country specific indicators to carry out its assessment precisely. The assessment can be carried out both at national and sub national level.

The 28 indicators for the country’s PFM system are structured into three categories: first one is PFM system out-turns: these capture the immediate results of the PFM system in terms of actual expenditures and revenues by comparing them to the original approved budget, as well as level of and changes in expenditure arrears. Second one is the Cross-cutting feature of the PFM system: these capture the comprehensiveness and transparency of the PFM system across the whole of the budget cycle. Third one is the Budget cycle: these capture the performance of the key systems, processes and institutions within the budget cycle of the central government. In addition to the indicators of country PFM performance, this framework also includes Donor practices: these capture elements of donor practices that affect the performance of country PFM system (PEFA Report 2005, p 5). However, this framework does not measure the factors impacting performance and it does not carry out any fiscal or expenditure policy analysis as well. The Donor practices indicators are not included in PEFA 2016 framework.

Based on PEFA Assessment, PFM performance report should be prepared; it is a concise document that communicates the results of overall indicators. It is a standardized report, which provides assessment on PFM performance based on the indicator led analysis. The contents of that documents are; Introduction with the context for the assessment, Country background information, Evidence & justification for scoring the indicators, Country specific issues, Description of
reform progress & factors influencing it and the Summary assessment of PFM system impact. However, the report does not include recommendations for reform.

According to the **PEFA Assessment guideline 2012**, the indicators used in the assessment may have one or more than one dimensions and each of these dimensions should be separately assessed. The assessment of individual dimensions gives the overall score of an indicator. A four point calibration is used for scoring which may be A, B, C and D in descending order or 1, 2, 3 and 4 in ascending order. Most indicators have 2, 3 or 4 dimensions and each dimension must be rated separately. Moreover, Aggregate dimension scores for indicator; two methods M1 or M2, specified for each indicator and Intermediate scores (B+, C+, D+) for multidimensional indicators, where dimensions score differently. There are two types of scoring methods, one is Scoring method M1: It is used for single and multi-dimensional indicators and in this method the lowest score among the dimensions is chosen after scoring all the dimensions and a “+” is added if other dimensions’ performance is better. There is a provision like “+” is not to be added for a single dimension indicator. Another scoring method is M2: It is used or multi-dimensional indicators with 2-4 dimensions. It is based on averaging the scores of the individual dimensions based upon the conversion table. The PEFA assessment guideline report has provided the **conversion table** for scoring method 2 only.

Under the Public Expenditure and Financial Accountability (PEFA) Program, the public financial management (PFM), Performance Measurement Framework (PMF) or (PEFA Framework) has been developed as a contribution to the collective efforts of many stakeholders to assess whether a country has the tools to deliver three main budgetary outcomes.

**6. PEFA Framework in Practice**

In absence of strong Public Financial Management System, it was always difficult to convince the development partners whether the developmental goals were being achieved or not. A tool was needed to assess the situation of Public Expenditure, and financial accountability. That is the reason The Public Expenditure and Financial Accountability or PEFA Program was founded in 2001 as a multi-donor partnership between: The World Bank, The European Commission, The UK’s Department for International Development, The Swiss State Secretariat for Economic Affairs, The French Ministry of Foreign Affairs,
The Royal Norwegian Ministry of Foreign Affairs, and The International Monetary Fund. More than 160 countries in the world assess their PFM system under PEFA Framework.

7. PEFA Framework in Nepalese Practice

In Nepal, PEFA Assessment was conducted in 2007-08. Its report was published in 2008 with 31 globally recognized performance indicators. The report paved way to formulate a Development Action Plan, which identified 147 immediate and intermediate activities to be performed. First PEFA Assessment had conducted in 2007 based on the data of 2003/04, 2004/05 and 2005/06. The report was published in 2008. After the recommendation of this assessment report 147 reform action-plans were identified and implemented. One of the major reforms of this is successful roll out of Treasury Single Account (TSA) and many other reforms are ongoing. Second PEFA Assessment has conducted in 2015 based on data of 2011/12, 2012/13 and 2013/14 and second phase PFM reform strategy action plan is approved on March 2016. This will be the next milestone in PFM System of Nepal.

8. Conclusion

Public financial management assessment is an integral activity which supports transparency, accountability and efficiency for better planning and execution of the incoming and outgoing of public funds. It helps strengthening governance, optimizing outputs from resources and ensuring inclusive and broad based development. It helps in strategic planning and optimum utilization of the available funds. On the basis of budget allocation, composition, auditing, use of donor funds, revenue and expenditure pattern etc. the performance of any country is evaluated. This helps in further planning, analysis, reforms and changes, performance evaluation, identifying variation and deviation etc. the scoring techniques are fixed and the given dimensions are only studied for the evaluation process.

PEFA Framework is a mechanism for strengthening public expenditure system of a country. It pays high priority to transparency and accountability in utilizing and managing public funds (Head of PEFA, Washington, pefa.org). The core objective of PEFA is to enhance expenditure management of the public funds and reduce associated fiduciary risk. This tool is very useful for the country's Performance evaluation. As PEFA is only the performance evaluation tool,
country can evaluate own self, however it is not the diagnostic tool so as per the gap shown by PEFA indicators, reform strategy should be adopted by the country itself. Further PEFA Assessment Nepal should develop the ground for new PEFA 2016 as per the new PFM pillars, indicators and dimensions.

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Abstracts

Policymakers face unseen and unpredictable opportunities to reduce poverty and improve human welfare. Better economic policies and sustainable growth is major concern for reducing poverty in developing countries. Policymakers around the world are always concerned with the challenge of maintaining the momentum in economic growth. The economic growth or more specifically quality growth is always linked with the reduction of poverty and inequality. Fiscal policy is one of the most powerful instruments that governments use to maintain macroeconomic stability for growth, as well as for intra- and intergenerational transfers of wealth and for correcting market failures.

Background

The word fiscal came from a French word fiscal, which means treasure of government. One of the major duties of government is conducting fiscal policy. Fiscal policy helps the government to collect funds from different resources and utilize for different expenditure. Fiscal policy is closely related to developmental policy because the major welfare projects are carried out under public expenditure. Fiscal policy has a pivotal role in shaping the government taxation and expenditure to achieve desired economic and social objectives. Sound and sustainable government policy is necessary for promoting economic growth and stability. It is an ingredient for poverty reduction too (IMF, 2006).

The objectives of fiscal policy depend upon the level of economic development of a country. This may vary from country to country. However, the major common objectives are resource mobilization, resource allocation, redistribution of income, balanced regional development, capital formation and national income, employment generation, price and economic stability, control over inflation and
so on. The policy helps the government to mobilize for public expenditure and development. The resource mobilization can be done through taxation, public saving and private savings which can be through issuance of bonds and securities. The funds mobilized are further allocated for development of social and physical infrastructure. Government collects tax as revenues and allocates to various ministries to accomplish different developmental schemes. Redistribution of income is also a fundamental aspect in reducing inequalities of income among the citizens of the economy. For example, the tax collected from the higher income citizens are spent on social upliftment of citizens with the lower or no income. Employment generation is also another important objective which can be done through speeding up the infrastructure development. Government tries to manage balance between trade imbalances and maintain a favorable balance of trade and balance of payment in the country. This can be achieved through promoting exports and in cash the foreign exchange. The expenses are distributed in sectoral and regional basis for uplift of less developed sectors. Fiscal policy measures help in increasing the capital formation and economic growth. Increased capital formation leads to increase in nation income.

**Components of Fiscal Policy**

There are two types of fiscal policy in practice. The first one is the expansionary which is most popular and widely used. It stimulates the economic growth. The government either spends more, cut or reduce tax or does the both. The main idea is to put more money into consumer's hand, so they spend more. Spending more creates demand which boosts the business and ultimately add jobs. This is demand side economics however the supply side economics prefer tax cuts. The second one is the contractionary fiscal policy which is rarely used. The goal of such policy is to slow economic growth. Most of the economies of world do not want to slow economic growth but this may be done to stamp out inflation. This is because the long term impact of inflation can damage the standard of living. This is usually practiced by matured economy or developed economies.

Moving towards the component of fiscal policy, the first tool is taxation. This includes income, capital gains from investments, property, sales etc. Taxes provide the major revenue source that funds the government. The downside of taxes is that whatever or whoever is taxed has less income to spend themselves which may makes taxes unpopular.
The second component is government spending. That includes subsidies, transfer payments including welfare programs, public works projects, and government salaries. Whoever receives the funds has more money to spend. That increases demand and economic growth.

**Economic Growth**

Economic growth means an increase in the capacity of an economy to produce goods and services, compared from one period of time to another. The growth can be measured in nominal and real value. Real growth is such growth which is adjusted for inflation. Economic growth means an increase in real national income/national output. The economic growth rate provides insight into the general direction and magnitude of growth for the overall economy. Economic growth and economic development are two different concepts. Economic growth measures an increase in real GDP. It basically measures the total volume of goods and services produced in an economy. Economic development looks at a wider range of statistics than just GDP per capita. Development is concerned with how people are actually affected. It looks at their actual living standards and the freedom they have to enjoy a good standard of living. Economic development means an improvement in quality of life and living standards, e.g. measures of literacy, life-expectancy and health care.

Economic growth can be generated through the discovery or better use of economic resources, increase in labor force, invention and use of newer and sophisticated technology, increased in specialization and so on. The better allocation and mobilization of resources can be effectively managed through the fiscal policy. The allocation is made focusing on current, capital and financial expenditure which when managed rationally can increase economic growth. Eventually economic growth leads to economic development.

**Highlights of Fiscal Policy, 2017**

The finance minister presented the fiscal policy for the fiscal year 2017 (mid-July 2016 to mid-July 2017) on May 29. The policy is expansionary in nature. There is a notable increase in spending. Further the policy is focused on distributive programs, post-earthquake reconstruction and priority projects infrastructure. The major highlights of the policy are summarized as;
The substantially larger size of the budget is due the large increase in recurrent and capital spending. This is higher by 28% as compared to budget estimates of fiscal year 2016. The economic growth target has been set 6.5 for the current year. Economic growth is an increase in the capacity of an economy to produce goods and services, compared from one period of time to another. It can be measured in nominal or real terms, the latter of which is adjusted for inflation. Traditionally,
aggregate economic growth is measured in terms of gross national product (GNP) or gross domestic product (GDP). It is very usual that in every fiscal policy, government sets a defined GDP growth rate and defend it with the resource allocation. The chart below depicts the comparative study of estimated growth rate and actual rate.

**Targeted and Actual GDP Growth Rate**

Every year, government publishes its program and allocates resources for such program. Along with that, government sets a goal that and prepares plans and programs accordingly. Government targets a specific GDP growth rate through the fiscal policy and government and associated stakeholders plays a vital role in meeting the target. It is always good to have a balance between targeted and achieved growth rate at the end of fiscal year. So here I would like to highlight the comparative analysis of targeted and achieved growth rate for last 10 years.

**Comparative analysis of targeted and actual GDP growth rate**

![Bar chart showing targeted and actual growth rate]

The chart shows that the actual or achieved GDP growth rate has exceed twice in 10 years of time. The FY 2007/8 and 2013/14 can be considered as the successful year with respect to growth rate. However, in the FY 2015/2016 seems to be significantly lower (0.77%) than the targeted growth of 6 percent. The growth of agricultural sector is estimated to be 1.3 percent due to the unfavorable weather. Similarly, the growth of non-agriculture sector is estimated to remain at 0.6 percent. This is because of the effect of earthquake and supply disruptions along with the disturbances in border points.
Conclusion

Fiscal Policy and economic growth are two interdependent aspects for every policy makers. Fiscal policy from a aspect of fiscal policy is that that government plays a central role in economic development by providing public goods and infrastructure whereas another aspect of fiscal policy is that it stifles dynamic economic growth through the distortionary effects of taxation and inefficient government spending. Policymakers around the world are always concerned with the challenge of maintaining the momentum in economic growth. The economic growth or more specifically quality growth is always linked with the reduction of poverty and inequality. Fiscal policy is one of the most powerful instruments that governments use to maintain macroeconomic stability for growth, as well as for intra- and intergenerational transfers of wealth and for correcting market failures. The challenge for government always remains for the achievement of quality and targeted economic growth.

References


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An Overview on Remittance and Its Impacts on Economy

- Shiva Regmi*

Abstract

Looking at current status, the workers remittance in Nepal has grown up by 7.7 percent amounting to Rs. 665.06 billion in FY 2015/16. Moreover, the ratio of remittance to GDP was 29.1% in previous year but it has increased to 29.6 percent in current year. With the higher ratio, we can infer that our economy is highly dependent on remittance. It has been a major component to bring balance in current account of BOP through the incremental growth in remittance every year. Hence, the article has focused on international remittance and its impacts in Nepalese economy.

Keywords:
Remittance, Gross Domestic Product, Balance of Payment, Dutch disease

Introduction

Remittance is not a new concept. It has been in existence from a long time back. Remittance can be classified into two major categories: Domestic and International. Domestic Remittances are those funds which are transferred from a location to another within the territory of country. It is a transfer of funds from an individual who holds a business or works in city or in urban area and transfer funds to his/her family members in the rural area or villages. Sometimes, funds may be transferred from rural to urban area as per needs. Meanwhile, International Remittance is a transfer of funds from a country to another country. The transfers are usually from developed economy to developing or underdeveloped economy. In a layman term, Remittance is a money sent by individual who work and live in developed (sometimes may be developing) economy to his/her family members and relatives who live in home country. International remittance here is different from foreign aids which is also a form of transfer from country to country.

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Although there are two categorization of remittance, the article will be more focused on international remittance and its impacts in economy.

Remittances consist of goods or financial instruments transferred by migrants living and working abroad to residents of the home economies of the migrants. Remittance is an important source of foreign income for under developed and developing economies. The value and volume of transferring funds has been growing in size over recent decades. It can also be considered as a private income that is regularly or periodically transferred from international migrants to family members in their country of origin (Dhungana, 2012).

**Nepalese Economy and Remittance**

Nepal, the land locked mountainous country in between India and China is bordered by Tibet to the North and India to the east, west and south. With an area of 147, 181 square kilometers (56,827 sq miles) and a population of 27.8 million, Nepal is the world's 93rd largest country with reference to land mass and 46th most populous country. The GDP of Nepal is around USD 21 billion and GDP per capita is around USD 740. The main sector of economy in Nepal is agriculture which accounts around 33 percent of GDP and employs over 70 Percent of population. Nepal is a home to highest mountains in the world; tourism has been growing as an important source of revenue. Remittance is also a strong component which holds a strong position in Nepalese economy. It has transformed lives of large number of rural people. The history of Remittance inflow in Nepal started after becoming a member of the UNO in 1955. The membership extended its cordial relationship with member countries and at the same time there was a pace of rapid globalization. This gave a breakthrough and paved a way for Nepalese workers to go abroad for employment. Thousands of Nepali workers went abroad and started to send money to their home. The amount of remittance received by Nepal in 1975/76 was Rs. 231.3 million which rose by twice in 1985/86 (Ojha, 2013). With the globalization and being member of international forum, Nepali workers have been able to go abroad, especially to the Arabian countries for employment and thousands of Nepali youths go across the border to India for temporary employment as there is free entry and exit policy between Nepal and India.

Several Nepali migrants workers were getting job especially in USA, Japan, South Korea and gulf countries and the trend showed the numbers was increasing before
2005, however after 2006/2007 an economic disorder overlapped the smoothly going investment and the employment trend in those countries were eventually the demand for foreign workers was cut off and shrunk to minimal. This was an affect of global recession. According Department of Labor (GoN), more than 23 thousand workers had left Nepal for foreign employment in 2009 but this shunned down to 17 thousand in the following year, since Malaysia, South Korea and other gulf-countries are major destinations for the Nepali workers the recessionary wave experienced by these countries compelled them to cut off labor employment (Ojha, 2013).

Now having a look to current status of Nepal, the workers remittance grew up by 7.7 percent amounting to Rs. 665.06 billion in FY 2015/16. The remittance growth rate in previous fiscal year was 13.6 percent. The reason for decreasing growth may be the number of workers leaving for foreign employment. The number has decreased by 18.4 % in current year as compared to previous year. One of reason to decrease the number for foreign employment is the devastating earthquake which forced the youths to stay in their home for reconstruction of their collapsed houses. Moreover, the ratio of remittance to GDP was 29.1% in previous year but it has increased to 29.6 percent in current year. With the higher ratio, we can infer that our economy is highly dependent on remittance. It has been a major component to bring balance in current account of BOP through the incremental growth in remittance every year.

The summarized form of foreign employment for FY 2014/15 and 2015/16 is listed in table.

<table>
<thead>
<tr>
<th>Foreign Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of workers</td>
</tr>
<tr>
<td>Country</td>
</tr>
<tr>
<td>Year</td>
</tr>
<tr>
<td>Saudi Arabia</td>
</tr>
<tr>
<td>2014/15</td>
</tr>
<tr>
<td>Qatar</td>
</tr>
<tr>
<td>2015/16</td>
</tr>
<tr>
<td>Malaysia</td>
</tr>
<tr>
<td>2014/15</td>
</tr>
<tr>
<td>UAE</td>
</tr>
<tr>
<td>2015/16</td>
</tr>
<tr>
<td>Kuwait</td>
</tr>
<tr>
<td>2014/15</td>
</tr>
<tr>
<td>S Korea</td>
</tr>
<tr>
<td>2015/16</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Country wise share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
</tr>
<tr>
<td>2014/15</td>
</tr>
<tr>
<td>2015/16</td>
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<tr>
<td>19.2</td>
</tr>
<tr>
<td>33.1</td>
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<tr>
<td>24.2</td>
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<tr>
<td>30.8</td>
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<tr>
<td>39.5</td>
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<tr>
<td>14.6</td>
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<tr>
<td>10.5</td>
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<tr>
<td>12.6</td>
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<td>1.9</td>
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<td>2.4</td>
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<tr>
<td>1</td>
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<tr>
<td>1.8</td>
</tr>
</tbody>
</table>
The rank of destination countries changed in the review year. Saudi Arabia topped followed by Qatar and Malaysia as major destinations for employment in the year 2015/16. In the previous year, Malaysia, Qatar and Saudi Arabia were in this order.

The table shows that the number of migrant's workers in current year is lower by 18 percent as compared to previous year. The table also shows that Nepalese workers are been at Afghanistan for foreign employment. It clearly depicts that workers are taking risk because they have been in countries where the situation is unstable and life remains always at risk.

**Is Remittance always beneficial?**

The growing remittance has always fed a long-standing debate on their positive and negative consequences. Some studies have noted that the remittance flows can improve the livelihoods of receiving households. The received amount helps to maintain daily expenses, education and health needs. Eventually it helps in capital formation and leads to capital investments. Whereas, some studies have noted how remittance hurts the economy by initiating a culture of dependency which reduces the labor supply and promotes conspicuous consumption.

Remittances can increase the well-being of receiving households by smoothing consumption and improving living conditions. As the family receives money the

<table>
<thead>
<tr>
<th>Country</th>
<th>Migrant Workers</th>
<th>Remittances</th>
<th>Employment</th>
<th>Education</th>
<th>Health</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>2836</td>
<td>3844</td>
<td>0.6</td>
<td>0.9</td>
<td></td>
</tr>
<tr>
<td>Bahrain</td>
<td>4165</td>
<td>3146</td>
<td>0.8</td>
<td>0.8</td>
<td></td>
</tr>
<tr>
<td>Oman</td>
<td>2300</td>
<td>3059</td>
<td>0.4</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Afghanistan</td>
<td>1501</td>
<td>1419</td>
<td>0.3</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Israel</td>
<td>450</td>
<td>189</td>
<td>0.1</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td>598</td>
<td>167</td>
<td>0.1</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>7070</td>
<td>8149</td>
<td>1.4</td>
<td>1.9</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>512887</td>
<td>418713</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>% Change</td>
<td>-2.8</td>
<td>-18.4</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: NRB, Current Macro and Financial Situation of Nepal (Based on Annual Data of 2015/16)
purchasing power of household increases and they can spend for their basic requirements. Remittances facilitate the accumulation of human capital by making possible improved sanitary conditions, healthier life styles, proper healthcare, and greater educational attainment. This increases the consumption pattern of households and these acts like a financial injection which eventually results in increasing National Income and affects GDP. Remittances can ease the credit constraints of unbanked households in poor rural areas, facilitate asset accumulation and business investments and promote financial literacy. This helps to increase saving and saving results in capital formation for investment. Moreover, it has constructive impact on financial development consisting of increasing access and use of financial intermediaries. People visit to bank branches and open their account where they directly can receive remitted amount. This builds a confidence in public towards banking and helps in financial inclusion program.

Receiving money sent by foreign employment brings happiness in family. It definitely increases the living standard however it has negative chain effects in economy. Remittance can reduce labor supply and create a culture of dependency that inhibits economic growth. Workers remain out of country so several plots of formerly cultivated plots remains uncultivated and barren. The increased spending amount may lead to consumption of non-tradable goods, raise their prices, appreciate the real exchange rate, and decrease exports, thus damaging the receiving country’s competitiveness in world markets.

The worker who retires from abroad may not have any productive skills. Moreover, the money earned abroad may be used in purchase of land and building in urban areas. It supports in migration from rural to urban area however, several villages remains empty of youths and productive age group people. And the most important is that, if the youth depends high on foreign employment then it persistently increases muscles and brain drain which affects the economy.

At an aggregate level, positive effects include economic stability, improved creditworthiness, and greater access to foreign capital that can boost economic growth. At a macro-economic level, remittances have been found to hurt exchange rates and the export sector through the so-called Dutch disease.
**Dutch Disease**

The term Dutch disease was originally used to describe the difficulties faced by manufacturing in the Netherlands following the development of natural gas on a large scale which triggered a major appreciation of the real exchange rate. It has since been used to refer to any situation in which a natural resource boom, or large foreign aid, or capital inflows, cause real appreciation that jeopardizes the prospects of the tradable sector (Pablo A. Acosta, 2007). The theoretical framework of analyzing the Dutch Disease effect of capital inflows in small open economies was based largely on the Salter-Swan-Corden-Dornbusch model. Hiroyuki Taguchi and Bikram Lama in their research paper have examined the Dutch Disease effects of international migrant remittances by using a VAR estimation focusing on Nepal and Bangladesh. The study identified the existence of the Dutch disease in Nepal but not in Bangladesh. This was because in Bangladesh the received remittances was allocated more towards investment thereby contributing to capital formation while in Nepal the remittances were used more for consumption. Moreover Bangladesh has taken a positive stance to raise manufacturing sectors through the development of infrastructure and special economic zones since the 1990s, whereas Nepal has had no specific industrial policies as far as manufacturing sectors are concerned.

**Conclusion**

The positives of remittance have outweighed the negative effects of remittance in under developed and developing economy. Other than monetary gains, remittance are directly associated with greater human development like health, education, and gender equality. The Positive spillover effects with few expenditures and investments made by remittance receiving household's leads towards the wellbeing of entire community. Increased living standard leads to betterment of society and eventually in macro label it brings positive effects in national economy however overdependence and reckless expenditure and consumption may cause the economy to suffer from Dutch Disease.

**References:**


Constructing Effective Legislative Oversight of Budget in Nepal

- Rajendra Bajracharya*

“Clapping hands in favor of the approval of the budget by the Parliamentarian doesn’t limit the accountability of the Law Makers towards the Citizens.”

Abstract
Legislative oversight has always been at the heart of better financial management. And the role becomes even more vital when accountability has to be proven through efficient public service delivery by an executive body of government. The credit of restoring good governance in a country goes to the accountable authorities such as executive, peoples’ representative and the law-makers by the means of “Better Spending through Economic Responsiveness” through credible and reliable budget made under vigilance of proper legislative oversight. Hence, this article has evaluated various aspects and issues for making effective legislative oversight of the budgeting against well set standard of PEFA indicators and tried to draw attention for the further PFM reform initiative at one hand, while at other hand it has tried educate all the focal stakeholders such as peoples’ representative, executive and law-makers in their respective contexts and roles with an intention to uplift the PEFA indicators in new federal scenario of nation.

Keywords:
Legislative oversight, Executive, Lawmakers, Ex-ante oversight, Ex Post Oversight.

Introduction
Effective legislatures are fundamental for establishing governance in the country. This governance lies in maintaining public trust that is addressed by the system of legislative scrutiny or oversight known as the heart of our political system. Basically, legislature accomplishes three major functions in any nation (1) playing

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* Rajendra Bajracharya is the Former PEFA Coordinator of Nepal.
the representative role of people, (2) making laws and policies, and (3) performing oversight or scrutiny of law and policy implementation. By the way of legislative oversight, the legislature examines the work of the executive or government to whom it has delegated its power or authority to implement are properly done or not. The executive is accountable for his performance towards the legislature and the legislature is accountable to the people with regards to the implementation of law and policies by the executive.

What is oversight?
Oversight is the action of reaction on to initiatives and policies proposed by the executive or government. According to McCubbins and Schwartz “Oversight refers to the set of activities that a legislature performs to evaluate the implementation of policies”.

How can oversight be exercised?
The legislative oversight function is accomplished by using the powers of oversight and by using different means and measures like public hearings, auditing, legislative or parliamentary committees, etc. The oversight authority need complete information for effective oversight of the policies.

What is the impact of oversight of budget?
In almost all countries, the government’s power or authority to raise and spend public money is awarded by the legislature through the process of approval of the annual budget law. If the legislature does not rigorously scrutinize, examine and debate the law, its power is not being effectively exercised, and the government’s accountability to the electorate is undermined. The impact of legislative oversight of budget may not be always positive.

Is the government’s budget affected by oversight?
The constitution empowers legislature oversight over executive body on budget approval and its use. It is the legislature which creates accountability of the government towards the electorate. The realignment of democratic checks and balances in the budget approval process is a complex process knotted with other aspects of the political system of establishing people's representative, the electoral system, and the functioning of multi-party system. If there are votes of no approval on the budget proposal presented by the government, it is regarded as no confidence on the government or ruling party.
Ex-ante oversight of budget:

Legislature has the constitutional authority or power to examine the national budgets and delegate power or to authorize the governments to raise revenues and execute budget expenditures. However, the real practice of this power may be varies widely. In the prior phase or ex-ante stage of oversight, legislature attempt a more active role in the budgeting process, establishing policy priorities for budget preparation, making guidance on budget measures proposed by the government, defining authority to amend budget expenditures, legislative budget activism, reinstating the democratic process in budgeting and making legislative involvement in the budget process, using powers to modify or change the budget, re-defining the process of approving the budget law that give more influence to the legislature during the formulation and approval processes. Depending on the circumstances, there are some pros and cons of the ex-ante oversight of budget process. The legislative exercises of amendment on proposed budget may cause delay in budget approval or non-approval situation. In the ex-ante oversight of budget, the legislature asks or orders for pre-budget consultations with the Minister of Finance and National Planning Commission and asks for periodic statements from the Minister of Finance to the PAC on budget execution. Such type of oversight action may promote realistic and reliable budget proposal.

In some other circumstances, the ex-ante legislative oversight activism of budget process may create problems for the governments to weaken fiscal discipline and improper resource allocation. Legislature, largely, imposes its power for overspending and that in some instances, legislatures used to force for irresponsible government spending. Even if greater legislative activism in budget formulation does lead to some sorts of fiscal deterioration and degradation, this may create the consequences for greater public input and need for national consensus around the budget. Some time, legislature is compelled to draw attention and deliberations on the emerging views and inputs from people and media and providing a platform for more broadly based consensus on the national budget that would otherwise be the case.
Legislature can be the entry point into the budget process for business groups, academics, civil society organizations, and policy groups, and many actively solicit submissions from civil society (Wehner 2004).

Generally, the opposition party in the parliament may focus on expenditure controls and reductions of budget line rather than on new revenue measures for deficit budget. In this context, parliament may approve revised tax and more gender sensitive and inclusive budget to pass.

In many countries, ex-ante legislative involvement in the budget process is desirable. But the parliament does not consider this budget process as a priority rather than other political issues to debate.

In the situation of non-majority or collision government, if the demand of opposition party was not address by the government, its proposed budget may not be passed. Eventually, the government will face the parliament’s vote not to approve the budget that would be equivalent to a vote of no confidence in the government and that leads to the resignation of the government. In some cases, the legislature plays only a minor role in the budget process and use power to amend the budget.

Budget takes place in a broader political context taking into account of the agenda of the ruling political party with balancing between the power relationships of political participants. Thus, how much de facto rather than de jure influence the legislature has is largely determined by their majority. So, the passing of the budget law depends upon the dominant political majority and political party discipline as well as the legislature’s capacity to influence the budget. So, enhancing the capacity of the legislature to examine the budget means enabling the legislature to effective contribution for credible/reliable budget formulation. And this meaningful contribution also depends upon the availability of necessary information on time and with accuracy.

In addition, with the help of specialized budget committee, the legislature can play a significant role in budget formulation by making them involvement in-depth and technical debate with adequate supporting staffs, related resources, given sufficient time for deliberation. Generally, majority of parliamentarians are newcomers and are unfamiliar with the national budget process, in the presence of
budget committee, the budget office of the parliament has the ability to undertake in-depth analysis of the government’s proposed budget.

In Nepalese experiences, moderately, the programs and projects (large and splitting type) come from the pocket of the electoral, bureaucrat and planner rather than established policy based and people’s demand based which are overlooked and escaped from the legislative oversight or scrutiny. Examples of those cases could be seen more if minutely scrutinized and there is a big question that whether it is the effective and efficient allocation of available resources?

Therefore, the importance of ex-ante oversight of budget is crucial. It checks the budgeting process towards the right direction of making policy-based and optimum resource allocation based budgeting by the government.

**Ex Post Oversight of budget:**

There are many activisms of ex-post oversight by the legislature on the basis of the auditor’s reports. Government accounts, records and reports on annual budget implementation are independently scrutinized or audited by a supreme audit institution – the Office of the Auditor General. The findings of this audit and audit observations are made by the auditor - which may include value for money and performance auditing as well as financial or compliance auditing. If the legislative’s role in the budget cycle is effective, legislative recommendations based on audit findings are reflected in future budgets, thus allowing for continuous improvements in public financial accountability.

Auditor General is a constitutional body who oversees the financial functions of government from the side of the parliament and its reports are presented to the parliament. The Public Accounts Committee of parliament reviews the auditor’s findings, consider, discuss and clarify and justify them with the concerned government ministries and departments along-with the evidences and recommends for corrections and rectifications. The reports of this audit findings are then send to the full parliament for action. PACs are the legislative apex for financial scrutiny of government for improving transparency and accountability in government financial operations. Financial oversight is said to be effective when a cordial relationship is maintained between the PAC and the Auditor General. For this purpose, the PAC requires timely and standard quality audit reports from the
auditor and the auditor general is always aware of making effective PAC to ensure that the government takes audit outcomes seriously.

The government may be unwilling to accept any criticism or act on valid complaints, government’s dislike of legislative oversight and, in some cases its lack of interest in addressing the inherent weaknesses of the legislature, a lack of media and public involvement, and a weak ethical culture within both executive and legislature, which leads to public distrust of electoral in general. There are few examples of effective PACs: the PAC increased its activism by taking many more suspects cases to the courts for financial irregularity, the PAC and the media sometimes kept the scandals of budget in the public eye, demanding remedial actions by the government, imposed pressure to the government for tighten the fiscal discipline, etc.

**Making Effectiveness of Legislative Oversight of Budget through PEFA Framework**

Government of Nepal has already recognized the PEFA framework as a major reform agenda for its public financial management. Through the first PEFA assessment in 2008 it has developed and implemented the first phase PFM reform strategy and action plans which have shown and proficient remarkable reforms in treasury management, budgeting, accounting and reporting of budget operations, procurement management, auditing and capacity development. Second PEFA assessment report 2015 has identified the outcomes of these reform initiatives resulting improvements in different PFM performance indicators. However, the performance indicator relating to legislative scrutiny of budget has been weakened than before.

From the above explanation we came to know how important of legislative oversight/scrutiny of the budget process. Effective legislative oversight contributes not only making realistic and reliable budget but also supervising the operation of the government on doing the best implementation of the budget so as to achieve its desired objectives. Considering this importance, PEFA framework has identified legislative scrutiny as a major indicator (PI-18) to measure and to diagnose its status (strengths and weaknesses) so as to make aware of the concerned entities to initiate reform on this aspect. There are four sub-indicators or dimensions to assess the effectiveness performance of legislative scrutiny or oversight of the annual budget. Under this PEFA indicator, the nature and extent
of legislative scrutiny of annual budget is assessed taking into consideration of the extent to which the legislature scrutinized, debates, and timely approves the annual budget, to which the extent of the legislature’s procedures for scrutiny of budget are established and are followed and assess the existence of rules for in-year amendments of the budget by the executive without pre-approval by the legislature.

PEFA framework (2016) for assessing public financial management have mentioned about the sub-indicators or dimensions of this indicator with their measurement criteria and way of achieving highest performance scoring. In Nepal, we have already assessed this PFM indicator during the first and second repeat PEFA assessment. There are some standing strengths and weaknesses with justifiable explanations measured with the specified criteria of PEFA framework. Those are stated below:

**Performance Indicator-18.1: The scope of legislative scrutiny:** This dimension states that such legislative scrutiny should cover review of fiscal policies, medium-term fiscal forecasts, and medium-term priorities as well as the specific details of expenditures and revenue estimates. In certain jurisdictions, the review may be undertaken in two or more stages, possibly involving a gap between review of medium-term aspects and review of the details of estimates for the next fiscal year. In the absence of a legislature that performs legislative scrutiny functions, this dimension would score D because the requirements for a C score would not be met. On the contrary, if the legislature’s review covers fiscal policies, medium-term fiscal forecasts, and medium-term priorities as well as details of expenditure and revenue then its performance will be scored as A. Second PEFA assessment scored it as A because there was no functioning legislature during the review period.

**Strengths and Weaknesses:** The Ministry of Finance, on the basis of the programs and policies approved by the National Planning Commission, prepares the annual budget. Now, the Constitution of Nepal has made the provision of submitting or presenting the annual budget in the Parliament within the 15th of Jestha i.e. one and half month prior to the start of the coming fiscal year. When the Finance Minister presented the annual budget to the Parliament on behalf of the Government after Cabinet approval then it is forwarded to the Finance...
Committee of the Parliament for detail examination and recommendations. The Finance Committee examines the budget allocated for various programs on the basis of priorities and submits its report, with recommendations, to Parliament. However, there is minimum possibility of meaningful pre-budget discussion between the legislature and executive body and rare chances of changes in the budget. Then with the tabling of budget for parliamentary approval initiates the debate on the revenue, programs and budget allocated. In Nepalese parliamentary practice, any change in the budget amount is equivalent to vote of “no confidence”; and no practice of presenting separate annual fiscal policy, medium-term fiscal framework and medium-term priorities for discussion in Parliament, hence the Parliament made approval of the budget without breaching its ceiling with considerable suggestions to the executive body to take into account while executing the budget.

**Performance Indicator-18.2: Legislative procedures for budget scrutiny:** This dimension states that the legislature’s procedures to review budget proposals are approved by the legislature in advance of the budget hearings and are adhered to. Here we examine the extent to which review procedures are established and adhered to. This includes public consultation arrangements, internal organizational and committee arrangements, technical supports, and negotiation procedures. The existence and timing of relevant procedures should be verifiable by reference to records of legislative sessions and decisions. Adequacy of the budget documentation made available to the legislature is covered by PI-5. The performance of this dimension will be scored A when the legislature’s procedures to review budget proposals are approved by the legislature in advance of budget hearings and are adhered to. The procedures include arrangements for public consultation. They also include internal organizational arrangements, such as specialized review committees, technical support, and negotiation procedures.

**Strengths and Weaknesses:** There are well established legislature’s procedures provisioned in the Constitution of Nepal and set overall guidance for the review. The Working Procedure Rule of Parliament has set detailed procedures for reviewing the appropriation and finance bills and other bills related to the budget that is followed by the Parliament while reviewing the budget. There are various review committees in Parliament that examine the annual budget and submit recommendations. The recommendations submitted by the parliamentary
committees are accepted after deliberation, and the budget is revised accordingly, if necessary.

**Performance Indicator-18.3: Timing of budget approval:** This dimension states that the timeliness of the scrutiny process in terms of the legislature’s ability to approve the budget before the start of the new fiscal year. The deadline is important so that budgetary units know at the beginning of the fiscal year what resources they will have at their disposal for service delivery. The time available for scrutiny is largely determined by the timing of the submission of the executive’s budget proposals to the legislature. Specify the actual time that legislature has spent in reviewing the budget proposal. When the legislature has approved the annual budget before the start of the year in each of the last three fiscal years then the performance of this dimension will be scored as A.

**Strengths and Weaknesses:** There is no provision in the system for involving the legislature during the budget preparation cycle, and it has no role in reviewing the budget proposals. The time allowed for the legislature's review (about one and half month) is clearly insufficient for a meaningful debate. As there was no Parliament during the second PEFA assessed period, the budget was implemented through presidential ordinance.

**Performance Indicator-18.4: Rules for budget adjustments by the executive:** This dimension states that the arrangements made to consider in-year budget amendments that do not require legislative approval. Such amendments constitute a common feature of annual budget processes. To avoid undermining the credibility of the original budget any authorization of amendments by the executive must adhere to clearly define rules. If there are clear rules for in-year budget adjustments by the executive and the rules set strict limits on the extent and nature of amendments and are adhered to in all instances then the performance of this dimension will be scored as A.

**Strengths and Weaknesses:** The legislature reviews government policies that are the basis of annual budget preparation. With respect to rules for in-year budget amendments without ex-ante approval by the legislature, the Financial Procedure Act has clearly defined the conditions under which the executive can amend the budget. It also specifies the limits on the extent and nature of the amendments.
The Secretary and the Head of the Department have authority for virement up to 25 percent of the approved expenditure from one line item to another without affecting the approved programs. These rules are usually respected but administrative reallocation is large.

**Availability of Budget Information for Legislative Oversight of Budget**

Similarly, PEFA framework has mentioned about the availability of information to the legislature regarding the budget preparation from the executive. On the basis of this information the legislature perform the oversight function of the annual budget.

**PEFA indicator PI- 5 (previously 6): Adequacy of the budget documentation made available to the legislature.** Annual budget documentation (the annual budget and the supporting documents) as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government’s fiscal forecasts, budget proposals, and outturn of previous years. In addition to the detailed information on revenue and expenditures, and in order to be considered complete, the annual budget documentations should include information on basic elements and additional elements as follows:

**Basic elements**

1. Forecast of the fiscal deficit or surplus or accrual operating result.
2. Previous year’s budget outturn, presented in the same format as the budget proposal.
3. Current fiscal year’s budget presented in the same format as the budget proposal. This can be either the revised budget or the estimated outturn.
4. Aggregated budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year with a detailed breakdown of revenue and expenditure estimates. (Budget classification is covered in PI-4.)

**Additional elements**

5. Deficit financing, describing its anticipated composition.
6. Macroeconomic assumptions, including at least estimates of GDP growth, inflation, interest rates, and the exchange rate.
7. Debt stock, including details at least for the beginning of the current fiscal year presented in accordance with GFS or other comparable standard.

8. Financial assets, including details at least for the beginning of the current fiscal year presented in accordance with GFS or other comparable standard.

9. Summary information of fiscal risks, including contingent liabilities such as guarantees, and contingent obligations embedded in structure financing instruments such as public-private partnership (PPP) contracts, and so on.

10. Explanation of budget implications of new policy initiatives and major new public investments, with estimates of the budgetary impact of all major revenue policy changes and/or major changes to expenditure programs.

11. Documentation on the medium-term fiscal forecasts.

12. Quantification of tax expenditures.

When the budget documentation fulfills 10 elements including every basic element (1-4) then the performance of this indicator will be scored as A. In the previous assessment there were 9 elements and fulfills 7 element out of 9 and got A score. The above documentation elements are revised and updated and many of them are challenges to meet.

The first PEFA assessment report 2008 and the second PEFA assessment report 2015 have assessed this indicator of which the comparative results are stated below:

PI-18: Legislative scrutiny of budget.

<table>
<thead>
<tr>
<th>Sub-Indicator/Dimension</th>
<th>First PEFA Assessment 2008</th>
<th>Second PEFA Assessment 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>PI-18.1: Scope of budget scrutiny</td>
<td>C</td>
<td>D</td>
</tr>
<tr>
<td>PI-18.2: Legislative procedures for budget scrutiny</td>
<td>D</td>
<td>NA</td>
</tr>
<tr>
<td>PI-18.3: Timing of budget approval</td>
<td>D</td>
<td>NA</td>
</tr>
<tr>
<td>PI-18.4: Rules for budget adjustments by the executives</td>
<td>B</td>
<td>NA</td>
</tr>
<tr>
<td>Aggregate Score</td>
<td>C</td>
<td>D</td>
</tr>
</tbody>
</table>

PI-5: Budget documentation (for legislative scrutiny)

| PI-5: Budget documentation (for legislative scrutiny) | B | A |
The above comparative table shows that the aggregate score for legislative scrutiny of budget has been downgraded in second PEFA assessment compared to the first assessment. But, in the budget documentation it is upgraded.

Nepal’s Public Financial Management Reform Strategy/Program (PFMRP) – Phase II has identified this aspect as one of the major reform area to be strengthen and it has embedded to implement some of the specific reform action plans with the objectives of improving timely discussion on ex-ante budget approval by the Parliament and discussion on audit reports, quality of recommendations and follow-up of the decisions made by the PAC. The action plans are as follows:

1. Develop and conduct capacity development programs for strengthening oversight functions of the Parliament to carry out review of the fiscal policy, budgeting and expenditure control.
2. Prepare and implement institutional/capacity development program of PAC and strengthen collaboration with OAG to ensure timely examination of audit reports.
3. Develop and implement specific Operational Procedures for PAC.
4. Develop and execute a monitoring (independent) system to monitor the implementation of PAC recommendations and directives.
5. Review adequacy and reliability of audit system by peer review mechanism.

There are some other reform action plans regarding multi-year (MTEF) and policy-based budgeting process and budget documentations that are significant for the effective oversight or scrutiny of the budget by the legislature. By implementing these reform action plans in the coming years, the relevant PEFA indicators will be upgraded and improved.

**Conclusion**

As there is no any doubt that the citizens always influence governance by revealing their preferences for services to their political representatives and making accountable them with active democratic participation to ensure that the government respects these services preference. Through the Parliament they set fiscal policy objectives, budgetary priorities, authorize budgets, and set expected outputs, outcomes, performance results and quality of life outcomes from the government administrations. To maintain this fiscal accountability some degree of legislative capacity is required to effectively scrutinize budgeting, budget appropriating, authorizing for budget revenue and expenditures, public accounts,
probe irregularities and feed findings and information sharing on all these works by the government. Generally, political electoral in the Parliament are elected from different fields and they are less aware of the budgetary systems and processes. Though, their tough accountability remains towards the people in providing effective and efficient service delivery and better living through the executive government administrations. The relationship between the legislature and the government is crucial and should be maintained properly for the welfare of the citizens and for desired economic growth and development. In this regards, budgetary process is one of the prime measure for polishing this relationship by which both the powers either the legislature or the ruling executive government have the opportunity to get the credit of effective budgeting. Therefore, our PFM reform initiatives should draw greater attention to implement and continue reform action plans to establish a proper mechanism of legislative oversight of the budget that make effective legislative oversight of budget in Nepal.

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# ANNEX

Annex 1: Summary of Score of the Sub-national PEFA Assessment

## Overall Summary

<table>
<thead>
<tr>
<th>PFM Performance Indicators</th>
<th>Local PEFA score 2014</th>
<th>Scoring method</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>DDC</td>
<td>VDC</td>
</tr>
<tr>
<td>PI-1 Aggregate expenditure out-turn compared to original approved budget</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>PI-2 Composition of expenditure out-turns compared to original approved budget.</td>
<td>D+</td>
<td>D+</td>
</tr>
<tr>
<td></td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td></td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>PI-3 Aggregate revenue out-turns compared to original approved budget.</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>PI-4 Stock and monitoring of expenditure payment arrears</td>
<td>B+</td>
<td>D+</td>
</tr>
<tr>
<td></td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>B</td>
<td>D</td>
</tr>
<tr>
<td>PI-5 Classification of the budget</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>PI-6 Comprehensiveness of information included in the budget documentation</td>
<td>B</td>
<td>B</td>
</tr>
<tr>
<td>PI-7 Extent of unreported government operations</td>
<td>A</td>
<td>A</td>
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<td></td>
<td>A</td>
<td>A</td>
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<tr>
<td>PFM Performance Indicators</td>
<td>Local PEFA score 2014</td>
<td>Scoring method</td>
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<tr>
<td></td>
<td>DDC</td>
<td>VDC</td>
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<tr>
<td>local PEFA score 2014</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td><strong>PI-8</strong> Transparency of inter-governmental Fiscal Relations</td>
<td>B</td>
<td>N/A</td>
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<tr>
<td></td>
<td>A</td>
<td>N/A</td>
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<td></td>
<td>B</td>
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<tr>
<td></td>
<td>D</td>
<td>N/A</td>
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<tr>
<td><strong>PI-9</strong> Oversight of aggregate fiscal risk from other public sector entities</td>
<td>C</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>C</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>PI-10</strong> Public access to key fiscal information</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td><strong>PI-11</strong> Orderliness and participation in the annual budget process</td>
<td>A</td>
<td>B+</td>
</tr>
<tr>
<td></td>
<td>A</td>
<td>B</td>
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<td></td>
<td>B</td>
<td>N/A</td>
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<tr>
<td></td>
<td>A</td>
<td>A</td>
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<tr>
<td><strong>PI-12</strong> Multi-year perspective in fiscal planning, expenditure policy and budgeting</td>
<td>D+</td>
<td>D</td>
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<td></td>
<td>D</td>
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<td>PFM Performance Indicators</td>
<td>Local PEFA score 2014</td>
<td>Scoring method</td>
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<tr>
<td></td>
<td>DDC</td>
<td>VDC</td>
</tr>
<tr>
<td>PI-13 Transparency of taxpayer obligations and liabilities</td>
<td>B</td>
<td>C</td>
</tr>
<tr>
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<td>PI-18 Effectiveness of payroll controls</td>
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<td>PI-19 Competition, value for money and controls in procurement</td>
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<td>PI-26 Scope, nature and follow-up of external audit</td>
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<td>HLG-1 Predictability and timeliness of transfers from higher level of government</td>
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**Comparison with Central PEFA assessment**

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