

Macro Assessment of the Public Financial Management System

Federal Republic Democratic of Nepal 2019



September 2020

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General Overview of Macro Assessment

Country being macro assessed	Federal Democratic Republic of Nepal
Agencies utilizing HACT framework in country	UNICEF, UNDP and UNFPA
Agency contact person(s)	Amir Das Rajbhandari
Start/end date of macro assessment (dd/mm/yyyy – dd/mm/yyyy)	March 2020 – May 2020
Has a macro assessment been performed for this country previously (by any organization)?	Yes. The last Macro Assessment was completed in 2012.
Member(s) of the macro assessment team (Name, designation, section/organization)	Deloitte Touche Tohmatsu India LLP
Sources of information used in assessment (title, date published, source, etc.)	As mentioned in bibliography

Background

As part of the United Nations system's efforts to enhance the effectiveness of development assistance, the United Nations Development Group (UNDG), comprising the United Nations Development Programme (UNDP), the United Nations Children's Fund (UNICEF), the United Nations Population Fund (UNFPA) adopted a common operational framework called the Harmonized Approach to Cash Transfers (HACT) for transferring cash to government and nongovernment implementing partners.

The implementation of HACT requires the UNDG- to conduct a macro-assessment in order to gain a perspective and adequate awareness of the country's public financial management (PFM) environment. The macro assessment in turn is expected to provide the national context in order to conduct micro assessment of each individual Implementing Partner to determine the specific risks involved when applying HACT.

Objective of the review

The objective is to ensure adequate awareness of the public financial management (PFM) environment in which agencies provide cash transfers to Implementing Partners. Therefore, a desk review of assessments of the PFM system will be conducted. The term 'PFM' in the harmonized approach to cash transfers (HACT) framework is broadly defined to include a range of considerations for operating within the country; it is not limited solely to the financial environment but also includes national procurement capacity, exchange rate volatility, presence of informal/black markets, etc. This assessment is called a macro assessment.

The two primary outputs of the macro assessment are:

- An outline of the risks related to use of the PFM for cash transfers within the country by governmental IPs, as well as other country-specific knowledge for non-governmental IPs; and
- A determination on whether the government's supreme audit institution (SAI) has the capacity to undertake scheduled and special audits of government IPs.

Disclaimers

The Report has been prepared by Deloitte Touche Tohmatsu India LLP ("DTTILLP") for the purpose laid down in Terms of Reference attached to our Long Term Agreement of Services ("LTAS") with UNICEF dated 42106653 dated April 11, 2019 and secondary contract 43296789 dated March 5, 2020 issued by UNICEF Nepal office to Deloitte Risk Advisory B.V.Netherlands.

- DTTILLP has prepared this report on the basis of information available at the date of this report. Nothing in this report should be taken to imply that DTTILLP has verified any information supplied to us or available in public domain.
- This report has been prepared based on a desk research and on information made available publicly from various sources. Our findings and assessments would have been more detailed and sufficiently conclusive, had country visits been undertaken.
- This report is intended solely for the information and internal use of United Nations agencies and is not intended to be and should not be used by any other person or entity. No other person or entity is entitled to rely, in any manner, or for any purpose, on this report.

Abbreviations

1	ASOSAI	Asian Organization of Supreme Audit Institution
2	CBS	Central Bureau of Statistics
3	DRM	Disaster risk management
4	DRRM	Disaster Risk Reduction and Management
5	DTCO	District Treasury Controller Office
6	DTTILLP	Deloitte Touche Tohmatsu India LLP
7	FCGO	Financial Comptroller General Office
8	FPR	Financial Procedure Regulations
9	GDP	Gross domestic product
10	HACT	Harmonized approach to cash transfers
11	HDI	Human development index
12	IMF	International Monetary Fund
13	INTOSAI	International organization of supreme audit institutions
14	IPSAS	International Public Sector Accounting Standard
15	LCB	Large commercial banks
16	LSGA	Local Self-Governance Act
17	LTAS	Long term agreement of services
18	MDA	Ministries, Departments and Agencies
19	MOF	Ministry of Finance
20	MTEF	Medium-Term Expenditure Framework
21	NEOC	National Emergency Operation Center
22	NPL	Non-performing loans
23	NPPSF	Nepal Public Procurement Strategic Framework
24	NPSAS	Nepal Public Sector Accounting Standards
25	NRB	Nepal Rastra Bank
26	OAG	Office of Auditor General

27	ODC	Other depository corporations
28	PAC	Public Accounts Committee
29	PEFA	Public expenditure and financial accountability
30	PFM	Public financial management
31	PPMO	Public Procurement Monitoring Office
32	SAI	Supreme Audit Institution
33	SCC	State Customs Committee
34	SOE	State Owned Enterprise
35	SRF	Standardized Report Forms
36	STC	State Tax Committee
37	TIP	Trafficking in Persons
38	TOR	Terms of Reference
39	TSA	Treasury Single Account
40	UN	United Nations
41	UNCAC	United Nations Convention against Corruption
42	UNDG	United Nations Development Group
43	UNDP	United Nations Development Programme
44	UNFPA	United Nations Population Fund
45	UNICEF	United Nations Children's Fund
46	UNODC	United Nations Office on Drugs and Crime

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Executive Summary:

The two primary outputs of the macro assessment are:

1. An outline of the risks related to the use of the PFM for cash transfers within the country by governmental IPs, as well as other country-specific knowledge for non-governmental IPs; and
2. A determination on whether the government's supreme audit institution (SAI) has the capacity to undertake scheduled and special audits of government IPs

The report has been prepared basis international reports and documents available on the system of public finance management in line with the risk checklist part of the Terms of Reference. The evaluation has been considered in depth for each of the defined parameters with suitable risks assigned.

The analysis of the public financial management system of the Federal Democratic Republic of Nepal showed that the indicators are categorized as follows:

- The content and exhaustive details captured in the budget, the discussion and finalization of the budget, procurement framework, independence and audit standards of SAI are allocated the lowest level of risk. Noted that in our view, allocation of low risk to these parameters highlights the degree of transparency in the budgeting process and the internal control over public financial management system that the Government is endeavouring to achieve.
- A moderate risk has been attained by the financial systems, implementation of the budget and audit implementation. This suggests that focussed efforts are being undertaken by the Ministry of Finance to gain control over the financial & internal control system in Nepal.
- The high risk parameters mainly include reporting of cash and asset positions, transfer of cash resources and internal controls. This stems from a dire need to implement the PEFA recommendations as per the previous report for transparency and monitoring. It should be noted that the analysis has shown that increased monitoring and streamlining of transfers and monitoring of bank accounts is required by the Government to enhance the control over such transfers. In this context, under transfers to the donor agencies/implementing partners, UN Agencies may perform enhanced monitoring – periodic spot checks to assess the accuracy of financial records for cash transfers to the IP as well as do assessments with regards to any significant changes in the applicable internal controls.
- Further, the black market and environmental conditions are volatile and Nepal is in stringent requirement of developing policies to further monitor the situation in the country.

In the context of the current PFM and internal control system, monitoring should be continued for donor assistance and budgetary controls. In view of the same, risk of unintended use of funds should be assessed basis current evaluation of control of public authorities over the financial system.

Key Recommendations to UNICEF in line with the objective of the Macro Assessment review:

Parameter	Comments
Outline of the risks related to use of the PFM for cash transfers within the country by governmental IPs, as well as other country-specific knowledge for non-governmental IPs.	<p>The open sources do not provide transparency on timelines for transfer of cash resources from central level to local level. Greater transparency is required with regards to timelines on transfers of cash resources from national/regional level.</p> <p>UN Agencies may conduct enhanced monitoring (Spot Checks at regular frequencies to assess the accuracy of financial records for cash transfers) in an organisation of high potential risk.</p> <p>Additionally, the Micro assessments determine the overall risk rating and assurance activities of the Implementing Partners financial management capacity. On transferring cash resources to the Government/Implementing Partners, UN Agencies may conduct an overall assessment by assessing the Implementing Partners on financial management capacity (i.e. accounting, procurement, reporting, internal controls, etc.)</p> <p>The overall risk rating determined by the micro assessment should be used by agencies in determining the appropriate cash transfer modality for the IP and the corresponding assurance activities</p>
A determination on whether the government's supreme audit institution (SAI) has the capacity to undertake scheduled and special audits of government IPs	<p>The Supreme Audits Institution has been well developed to impart independence and objectivity in its review. The SAI follows international standards and reports to the Parliament. However, the implementation of audit recommendations need further strengthening and enhanced monitoring.</p>

A detailed review of each risk parameter has been outlined as below:

1. Introduction

Officially the Federal Democratic Republic of Nepal, a landlocked country in South Asia bordered by the Indian states of Uttarakhand, Uttar Pradesh, Bihar and Sikkim, and in north by Tibet. Nepal has a population of 31 million (2016 est.).¹ Nepal is located in Southern Asia, between China and India, contains eight of world's 10 highest peaks, including Mount Everest and Kanchenjunga - the world's tallest and third tallest mountains - on the borders with China and India respectively. Nepal's climate varies from cool summers and severe winters in north to subtropical summers and mild winters in south.²

Nepal is among the least developed countries in the world, with about one-quarter of its population living below the poverty line. Agriculture is the mainstay of the economy, providing a livelihood for almost two-thirds of the population but accounting for less than a third of GDP. Industrial activity mainly involves the processing of agricultural products, including pulses, jute, sugarcane, tobacco, and grain.³

Central Bureau of Statistics (CBS) estimated the growth of real GDP (at producers' price) at 6.3 percent in 2017/18 compared to 7.9 percent in 2016/17. Merchandise exports grew 11.1 percent in 2017/18 to Rs. 81.19 billion compared to a growth of 4.2 percent in 2016/17. Total merchandise exports as percentage of GDP shrank to 2.7 percent in the review year from 2.8 percent in the previous year. Merchandise imports increased by 25.5 percent to Rs.1242.83 billion in the review year as against a growth of 28.0 percent in the previous year.⁴

Massive earthquakes struck Nepal in early 2015, which damaged or destroyed infrastructure and homes and set back economic development. Although political gridlock and lack of capacity have hindered post-earthquake recovery, government-led reconstruction efforts have progressively picked up speed, although many hard hit areas still have seen little assistance. Additional challenges to Nepal's growth include its landlocked geographic location, and underdeveloped transportation infrastructure.⁵

Nepal's HDI value for 2018 is 0.579— which put the country in the medium human development category—positioning it at 147 out of 189 countries and territories. Between 1990 and 2018, Nepal's HDI value increased from 0.380 to 0.579, an increase of 52.6 percent.⁶

¹ Nations Online – One World - Nepal

² The World Factbook - Nepal

³ The World Factbook - Nepal

⁴ Financial Stability Report

⁵ The World Factbook - Nepal

⁶ Human Development Indices and Indicators: 2019 Statistical Update – UNDP - Nepal

2. Fiscal Policy

Nepal's economy is enjoying a solid expansion, supported by ongoing reconstruction activity following the 2015 earthquakes and increased growth in manufacturing and tourism-related sectors. Real GDP is estimated to have expanded by 6.3 percent in FY 2017/18 (mid-July 2017 to mid-July 2018), and headline inflation averaged 4.2 percent, held down by subdued food-price inflation.⁷

Government expenditure increased by 32.4 percent (year-on-year) in FY 2017/18, propelled by Nepal's transition to fiscal federalism and ongoing reconstruction spending. As in previous years, spending was concentrated in the last quarter of the fiscal year. Revenue growth was also substantial (18.9 percent). Nevertheless, the fiscal deficit increased to 6.5 percent of GDP, from 3.1 percent of GDP in FY 2016/17.⁸

After two years of elevated growth, led by post-earthquake reconstruction activity, services and manufacturing, the economy is operating above its estimated potential. The near-term outlook for growth is favourable but inflation, external sector, and financial-stability risks are rising. Growth is expected to accelerate somewhat, to 6.5 percent in FY2018/19, well above its historical average. Inflation is projected to increase, touching 6.5 percent in FY2019/20. The current account and fiscal deficits are projected to remain wide, at 9.6 and 5 percent of GDP, respectively, in FY2018/19.⁹

Under staff's baseline scenario, which reflects the authorities' established policies, elevated near-term growth will put substantial pressure on the domestic economy and the current account, implying a need for a marked slowdown later to avoid a balance-of-payments shortfall.¹⁰

With this background, this section attempts to analyse the different parameters through which government has been successful in implementing its vision through its policy actions.

a) The annual budget contains all significant government expenditures, including relevant donor contributions

Budget expenditures are important tools of the government in implementing public responsibilities. To keep up with the rising GDP growth rate, Nepal's budget requires strategic result-based budgeting, which connects operations of government offices and expenditures being utilized in specified sectors such as education, environment, government ministries and more, to enhance improvement. A well-planned budget will contribute towards further efficient governance and functioning of various macro-economic

⁷ IMF – 2019 Article IV Consultation – Nepal

⁸ IMF – 2019 Article IV Consultation – Nepal

⁹ IMF – 2019 Article IV Consultation – Nepal

¹⁰ IMF – 2019 Article IV Consultation – Nepal

factors. The analysis tried to look at the fact whether significant expenditures and contributions are included in the budget to create an effective development plan.

As per the Budget Speech, 2019-20, Government have allocated Rs.1532.97 billion to implement the policies and programmes of the coming Fiscal Year. Out of total allocation, Rs.957.10 billion or 62.4 per cent is for recurrent expenditure, Rs.408.59 billion or 26.6 per cent for capital expenditure, and Rs.167.85 billion or 11 per cent is for financing.¹¹

Out of total estimated source of financing for the coming Fiscal Year, Rs.981.13 billion will be financed through revenue mobilisation and Rs.57.99 billion from foreign grants, which will lead to the deficit of Rs.493.83 billion. Rs.298.83 will be arranged from foreign loan to meet this deficit. After financing from revenue and foreign aid there will be a net deficit of Rs.195 billion will be financed through domestic borrowing. Based on the formula laid down by the National Natural Resources and Fiscal Commission, such as spending needs, status of human development indicators, resource mobilisation capacity and other economic, social and other inequalities among provincial and local levels, I have allocated Equalization Grants of Rs.55.30 billion and Rs.89.95 billion to the provincial and local levels respectively for the coming Fiscal Year. Under conditional grants, Rs.44.55 billion and Rs.123.87 billion have been allocated to the provincial and local levels, respectively.¹²

The major heads of expenditure including financing are:¹³

Item of expenditure	In Rs. lakhs	% of total
Economic Affairs	54,13,670	35
General Public Service	45,90,532	30
Education	16,37,559	11
Health	7,84,044	5
Social Protection	7,13,859 [#]	5
Housing & Community Amenities	7,87,545	5

[#]this includes the allocation made under the budget heading Social Security/protection only. However, it is to be noted that there are so many social protection related allocation under various ministries under different program headings. The National Planning Commission has estimated about 11.5% resource allocation on social protection.¹⁴

The major revenue estimates for 2019-20 include:

Item of revenue	In Rs. lakhs
Tax on income, profits and capital gains	27,21,861

¹¹ Budget Speech – Nepal – 2019-20

¹² Budget Speech – Nepal – 2019-20

¹³ Budget Speech – Nepal – 2019-20

¹⁴ National Planning Commission 2020

Tax on goods and services	53,30,847
Taxes on International trade and transactions	19,57,125
Property Income	4,72,069

The rate of economic growth is expected to be 8.5 per cent in the coming Fiscal Year through expansion of agriculture, industry and service sectors with accelerated economic and social infrastructure development, reconstruction and new construction.¹⁵

The budget presented gives details of all government expenditures along with detailed budget calculations for significant items. Further, the expected revenue break up and budgeted amounts and loans to be sourced from international agencies for covering up deficit are explicitly mentioned. Hence, the report assigns a low risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
The annual budget contains all significant government expenditures, including relevant donor contributions	Low risk	No	The budget is very detailed and provides in depth bifurcation of revenue and expenditure amounts including donor contributions.

b) Budget and Performance

The Annual budget can be considered as a blueprint of the government in its effort to govern the country in best possible way and achieve economic, political, social as well as socioeconomic growth within the country. The Annual budget should be exhaustive and should represent the details contained within for every government department. Hence, it is important that the budget is encompassing all the necessary funds and donor contributions to be sanctioned to the respective ministries and should be debated and be inclusive of all voices and opinions. With this opinion, the report looks at whether the budget is debated largely on a public forum.

¹⁵ Budget Speech – Nepal – 2019-20

The Budget Speech is uploaded on MOF website immediately upon its presentation in Parliament. All budget-related documents are uploaded on MOF website and also published. All expenditure reporting can be received on a real-time basis through the TSA system at the FCGO. The Ministry of Finance meets the press each month and delivers statements on monitoring of budget implementation, revenue and foreign assistance mobilization, and status of public expenditure and public enterprise management. The FCGO prepares the annual financial statements within six months and publishes the Consolidated Financial Report. The FCGO submits audit information to the OAG upon completion.¹⁶

The Ministry of Finance and National Planning Commission jointly prepare the national budget. There is active participation from ministries, departments, and agencies in budget preparation where settlements on outstanding issues are done. Parliament actively participates in policy debates. Active participation of the legislature in budget formulation through the Budget Committee is an area that could be further strengthened.¹⁷

There is a clear and detailed annual budget preparation calendar. The Budget Formulation Guideline contains all necessary information and guidance for MDAs on budget preparation, including calculators for respective data requested under budget request forms. The budget preparation starts with the issuance of a joint circular (NPC/MoF) with budget ceilings and guidance to the MDAs of the next FY budget priorities, four months before the start of the new fiscal year. This circular assigns dates of budget submission, negotiations, roles, responsibilities, and activities during the preparation process and responsibilities of the concerned institutions. Although several reasons can be assigned to missed deadlines, repeated budget negotiations force the MDAs to miss suggested budget preparation dates largely as a result of insufficient planning at the MDA level and incremental nature of budget ceilings that forces both the resource providers and users to negotiate several times. Otherwise, sufficient time (four months) is provided to MDAs to prepare, negotiate, and finalize the budget in a meaningful manner. A clear and comprehensive budget guideline with ceilings is then issued to the MDAs. This circular is the beginning of the budget preparation cycle, keeping the size within the limit set by the Resource Committee.¹⁸

The final size of the budget is larger than the ceiling reflecting the changed resource availability, and the Cabinet endorses this higher number before the budget is submitted Parliament. The Finance Minister submits the proposed budget to the Parliament for approval, a week before the start of the fiscal year (i.e., mid-July). It usually takes 2 months for Parliament to pass the budget and obtain the President's seal required by all laws. In the last three years, there were two instances when the budget was approved though an executive ordinance because there was no Parliament.¹⁹

¹⁶ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

¹⁷ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

¹⁸ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

¹⁹ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

As per the Budget Speech for 2019-20, the revised Government expenditure for the Fiscal Year 2018/19 is Rs.1208.37 billion, which is 91.8 per cent of the total allocation. The revised estimate for recurrent expenditure, capital expenditure and financing is 92.3, 86.9 and 98.1 per cent of the annual allocation, respectively. Revenue mobilization in the Fiscal Year 2018/19 is estimated to be Rs.860 billion. The revised estimate for mobilising foreign aid is Rs.46.77 billion in grants and Rs.210.28 billion in loans.²⁰

Further, it states, I am grateful to Honourable Members of the House of Representatives and the National Assembly for their suggestions based on extensive discussions on the principles and priorities of the budget. I express sincere thanks to prominent leaders of the major political parties, economists and planners, the private sector, cooperative sector and civil society for their suggestions.²¹

The report finds that the State Budget is well documented and debated extensively at various levels. Analysis of revenues and expenses is carefully considered taking into account including revenues and expenditures of previous years as well as revised estimates and estimates for following years. Hence, the report assigns low risk to this factor.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Budget and performance	Low risk	Budget decisions are fully debated with assistance from expert committees. Full consideration of previous performance is taken into account when setting future budgets.	The budget is well discussed in the Parliament and debated. Analysis of revenue and expense is carefully considered at the time of budget preparation.

c) Budget Execution

Apart from the preparation of the annual document, the efficient and effective implementation of the targets set out in the annual budget is of equal importance. Execution of the budget therefore is about the collection and accounting for revenue, provision of services through the recurrent budget and implementation of development projects. The report tries to analyse the progress made by the government in accordance with the annual budget.

²⁰ Budget Speech – Nepal – 2019-20

²¹ Budget Speech – Nepal – 2019-20

As per the Budget Speech for 2019-20, it was noted that the planned expenditure for FY 2018-19 was overshoot by 9%.²²

As per the PEFA report, in no more than one year in the last three years has the actual expenditure deviated by an amount equivalent to more than 5 percent of budgeted expenditure. In the three fiscal years under review, the actual expenditure went above the threshold of 5 percent only once in FY13. The deviation was 5.9 percent while the deviations for FY12 and FY11 were at 1.9 percent and 4.05 percent, respectively. A tighter and implementable budget size (guided by realistic budget formulation guidelines) and the mid-year budget review, which steered budget execution for remaining period of the fiscal year using data generated by the Treasury Single Account (TSA), strengthened budget formulation and use processes. These new processes supported by data are marked improvements compared to the first PEFA assessment.²³ There is no assessment done by PEFA post this report. The latest draft report is not finalised and hence not publicly available.

The total contingency budget (current and capital) as a share of budget is low. While the current contingency fund is for non-budgeted expenditure (natural emergencies, executive decisions, and others), capital contingency budget is appropriated for projects that were unable to complete negotiations within the budget preparation cut-off date.²⁴

The Budget and Resource Committee—Vice-Chair of National Planning Commission, Governor of the Nepal Rastra Bank (NRB), and MoF Secretary—prepares and provides the ceiling of the estimated resource (revenue and aid) availability and its use (budget expenditure) for any given fiscal year, thereby initiating the process of annual budget formulation process six months before the new fiscal year begins. Only in one year of the three fiscal years, was revenue collection below 97 percent of the target.²⁵

As per the IMF Report, Based on revenue and spending execution so far and remaining implementation capacity constraints, staff's baseline projection is a fiscal deficit of 5 percent of GDP FY2018/19. Aided by rising imports, rupee depreciation and a wide-ranging tax package (Annex III), revenues are projected to rise by 29 percent in FY2018/19 in the baseline (somewhat less than budgeted and subject to downside risk in view of the heavy reliance on import taxation). Despite improved disbursements of capital expenditure so far, some under-execution of investment is expected for the full year, reflecting both the legacy of an unrealistically large budget envelope and uneven spending capacity of local and

²² Budget Speech – Nepal – 2019-20

²³ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

²⁴ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

²⁵ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

provincial government. As per the budget execution table, in FY 2017-18, the execution rate was over 80%. ²⁶

All loan-financed project financial activity is reported, recorded and audited. There are some exceptions when it comes to grant-financed activities, some of which are implemented outside the government's purview. The Development Cooperation Report 2013 cites the status of aid reporting as follows: (a) on budget 64 percent and (b) on treasury (i.e., channelled through the Treasury and therefore included in FMIS and financial reports) as 46 percent. Only 29 percent (0.64×0.46) of all aid was fully reported. The Development Cooperation Report does not analyse this between grant and loan, but shows that 18.5 percent of all aid was on loan terms (US\$177.90 million), while 81.5 percent was on grant or technical assistance terms (US\$781.93 million). ²⁷

Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases. Although sector strategies are spelled out in the plan document, links between strategies and their investment and recurrent cost implications are weak. Few sectors like education, health, and rural roads have costed sector strategies. In absence of sector strategies, the business plans guide the investment, but it is limited to a broad level of recurrent aggregate cost structure. ²⁸

For the past three fiscal years, budgets featured overall deficit projections of around 8 percent of GDP, incorporating reconstruction spending and higher transfers and revenue sharing with subnational governments. Nevertheless, capacity constraints at the federal and subnational levels led to considerable under-execution and back loading of spending, especially for capital projects, and therefore lower deficits. Data for the first months of this FY also show a similar trend of underspending. In FY2018/19, the central government deficit narrowed to 4.6 percent of GDP (from 6.7 percent of GDP in FY2017/18), resulting in a negative fiscal impulse. Public debt is around 30 percent of GDP, implying a low risk of debt distress. ²⁹

Adequate government-service provision and sufficient levels of capital spending can only be achieved with a proper PFM architecture in place. In this regard, the recent enactment of the Financial Procedure and Fiscal Responsibility Act to strengthen internal audit practices, alongside recent PFM administration efforts by the Financial Comptroller General's Office, are important steps forward. However, further efforts are needed, including to strengthen the procurement process as discussed below. There is an ongoing

²⁶ IMF – 2019 Article IV Consultation – Nepal

²⁷ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

²⁸ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

²⁹ IMF – 2020 Article IV Consultation – Staff Report– Nepal

need to train staff at the SNG level and ensure that adequate controls and accountability are in place.³⁰

The PEFA Report shows that the budget plan is executed year on year with an execution rate of above 80% with limited exceptions. Although the budget execution rates are very high, they are not without exceptions and have scope for further improvement. Taking into consideration that budget execution is not yet 100 percent, the report assigns moderate risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Budget execution	Moderate risk	Government historically executes budgets as planned with limited exceptions.	Although the budget execution rates are very high, they are not without exceptions and have scope for further improvement

d) To what extent are internal controls and financial procedures adhered to

To address this point, the report will focus on parameters such as the effective execution of plans, compliance, as well as fiscal discipline and the resultant cost overruns. With regards to above mentioned parameter and the opinions given in the referred reports, the analysis finds that:

As per the PEFA Report, There are clear, legal provisions [Constitution, Article 9; Financial Procedure Act, Section 5, Financial Procedure Regulations (FPR) 2007] and systems and processes (Resource Committee, MTEF, Budget, Budget Authorization, and the release process) to guide and to enforce budget commitment controls. The OAG 2014 report states that 28 budget heads had expenditure above the allocation; this is 3 percent of fiscal year expenditure. While this alludes to presence of laxity in expenditure commitment control, the above situation is the result of virement undertaken, within economic codes and at project level, within a ministry matching the changing implementation environment on the ground. There is no record of any line ministries' expenditure that is above budget ceiling – the hard budget constraint set for all individual line ministries.³¹

³⁰ IMF – 2020 Article IV Consultation – Staff Report– Nepal

³¹ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

Rules and procedures under FPR 2007; procurement rules, operational guidelines, and norms prepared by the Ministry of Finance; and respective control rules and procedures in health, education, physical infrastructure, and local development sectors developed by MDAs govern internal controls and procedures of budget execution. But the enforcement is weak. Various OAG reports suggest developing and implementing internal control systems that contribute to improve fiscal discipline and to reduce fiduciary risks.³²

Rules are complied with in a significant majority of transactions, but use of simplified, emergency procedures in unjustified situations is an important concern.³³

As per the audit summary report for the Auditor – General, Internal audits of all government offices are being conducted through Financial Comptroller General Office and subordinate offices in accordance with Section 2(P) of Financial Procedure Act 1999 and Rule 96 of Financial Procedure Rules 2007.³⁴

All levels of government offices and corporate bodies should prepare and implement subject-wise and sector-wise internal control procedures to further strengthen the internal control system through the optimum use of public resources and making public service delivery economical, effective and efficient. Steps should be taken to adopt sector-wise code of ethics along with the mechanism for strict adherence and monitoring of such codes. Internal control system should be made effective by adopting good international practices along with the enhancement of operational independency, professional capabilities, standards & procedures, supervision methods, organizational frameworks for report submission etc.³⁵

It can be ascertained that an internal control system has been defined but effectiveness of the control system needs to be strengthened. With implementation of recommendations included in the OAG report, the same would be achieved. The report assigns a significant risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
To what extent are internal controls and financial procedures adhered to	Significant Risk	Procedures are generally followed, but there are significant exceptions. Doubt exists as to whether or not the internal control system can be relied upon.	The internal control procedure framework is designed but can be further strengthened to be effective.

³² 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

³³ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

³⁴ Office of the Auditor – General – Annual Summary Report 2018

³⁵ Office of the Auditor – General – Annual Summary Report 2018

e) Banking Reconciliations

Timely reporting of the government's cash position is an important aspect of the whole public management process as it helps understand where the money is going and further detect issues in real time. The analysis finds that;

As per the PEFA Report for 2015, a total of 1,988 treasury-managed accounts are in use. Bank reconciliation for all Treasury managed bank accounts takes place quarterly, usually within eight weeks of end of quarter. With the implementation of TSA system in FY2013, a single bank account (expenditure, revenue, deposit and other) for all spending units is operated by DTCOs.³⁶

The DTCOs perform "day close" function and send daily reports to NRB for account settlement. On the expenditure side, besides check-issued amount not being cashed, there was no other material difference. Issues of wrong labelling of source of fund have been addressed as per due diligence guidelines. On the revenue accounts, "material differences" are settled subsequently in the following month. Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period.³⁷

Further as per the audit summary report of the Auditor - General, the bank reconciliation statements have not been prepared pursuant to excess bank balances by NRs. 147.60 million than the books of accounts of 32 local levels and shortfalls in bank balances by NRs. 48.40 million than the books of accounts of 39 local levels.³⁸

In summary, bank account reconciliations are not performed for about 5% of the accounts as noted in the latest audit summary report. It is performed by DTCO's on a daily basis and quarterly reconciled for Treasury managed bank accounts. The report assigns a significant risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Bank Reconciliations	Significant risk	A number of significant accounts are not reconciled monthly. Quality is sometimes poor	Bank reconciliations for some bank accounts are not prepared. We are not able to ascertain whether follow up actions are taken in all cases.

³⁶ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

³⁷ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

³⁸ Office of the Auditor – General – Annual Summary Report 2018

f) National procurement policy

A well-established national procurement framework is essential to ensure sustainable, equitable and inclusive growth with the economy. The factors to look at in this segment are the presence and strength of such structures. A well-functioning procurement system can potentially ensure that funds are effectively used for achieving efficiency in delivery of programs and services by the government. The national procurement program can be built with the aim to stimulate growth in local industries, to use the program as a way to achieve socio-economic growth as well as to improve and increase capabilities of local institutions.

The analysis finds that;

As per the Public Procurement Act, 2005, A Public Procurement Monitoring Office under the Office of the Prime Minister and Council of Ministers shall be established in order to monitor procurement activities. The functions, duties and powers of the Public Procurement Monitoring Office:

- To make recommendation to the government of Nepal for reform in the procurement policy or laws in force
- To issue technical guidelines and manuals required
- To prepare standard model of the standard bidding documents, prequalification documents, procurement contract document and documents relating to proposal to be used by a Public Entity
- To establish and operate procurement website
- To make necessary criteria of exclusion from the blacklist under Section 63
- To submit the annual report of the procurement proceedings to the Government of Nepal.³⁹

Public Procurement Monitoring Office (PPMO) was established as per the provision made in the new Public Procurement law of Nepal. The Public Procurement Act, 2063 (B.S.) and Public Procurement Regulation, 2064 (B.S.) have been enforced on 2063/09/30 (B.S.) and 2064/5/03 (B.S.) respectively. PPMO was established as the government agency on 2064/5/3 (B.S.) and is placed directly under the prime minister. This organization has 51 staffs including the secretary as head of this institution.⁴⁰

For effective program delivery, PPMO started periodic programming in 2010, and prepared Nepal Public Procurement Strategic Framework (NPPSF) Phase I, which was implemented from 2010 to 2013. Important initiatives were taken and reasonable achievements were made during the 3-year program period. The second programming cycle begun in 2013 and this NPPSF Phase II document is the outcome of that process.⁴¹

³⁹ 2005 Public Procurement Act, 2063 - Nepal

⁴⁰ Public Procurement Management Office, Nepal

⁴¹ Public Procurement Management Strategy Report – Phase II – 2013-16

Prepared in a collaborative manner, the NPPSF Phase II has three strategic programmatic pillars: (i) public procurement system and process improvement, (ii) public procurement system capacity development, and (iii) e-GP system development and deployment. Under each pillar, 3-year goals have been envisaged as standardization of key public procurement processes; enhancement of professional skills and capacities of the main actors engaged in central level government procurement; and operationalization and mainstreaming of e-GP system in major government agencies.⁴²

As per the Auditor – General’s report, steps should be taken to grant time extension by determining the reasons and responsible persons for non-accomplishment of timely works as per procurement contract, make the tender submission through electronic system mandatory, conduct quality tests as per specified manner, keep the construction contractors in black-list that have not made progresses as per contract agreements. Clear legal provisions should be formulated in subject matters, the like – environment friendly development works management, preparation of norms for making cost estimates in Design-As-Built Contract, tender documents, price adjustment etc.⁴³

The Law on Public Procurement and the Public Procurement Monitoring Office are the pivotal institutional frameworks defined around the procurement policy in Nepal. It is evidenced that an adequate and robust public procurement framework is available and the report assigns a low risk to this factor.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Country has a national procurement framework	Low Risk	Yes	The country has a robust procurement framework including robust agency to monitor expenditures.

g) Transfer of cash resources

Intergovernmental transfers are the cornerstone of sub-national government financing in most countries. The alternative is to leave the bulk of revenue raising power at the central level, and to provide a subsidy to local government revenues to accommodate the

⁴² Public Procurement Management Strategy Report – Phase II – 2013-16

⁴³ Office of the Auditor – General – Annual Summary Report 2018

mismatch. The result is that transfers comprise a major component of subnational government revenues.

The function of federal, provincial and local levels will be systematised through augmenting functional clarity in regard to the use of concurrent authorities. The administrative structures of the federal, provincial and local level will be made functional. Fiscal transfer from Government of Nepal to the provincial and local level will be made equitable, based on the analysis of need and capacity.⁴⁴

Public accountability will be promoted by strengthening the inter-governmental fiscal transfer system, and integrated accounting and reporting of provincial and local level income and expenditure. Procedures for international development cooperation mobilisation and debt will be prepared and implemented. Recurrent expenditure of federal, provincial and local levels will be kept within the anticipated limit, and development finance will be focused on the priority sectors.⁴⁵

Based on the formula laid down by the National Natural Resources and Fiscal Commission, such as spending needs, status of human development indicators, resource mobilisation capacity and other economic, social and other inequalities among provincial and local levels, I have allocated Equalization Grants of Rs. 55.30 billion and Rs. 89.95 billion to the provincial and local levels respectively for the coming Fiscal Year. Under conditional grants, Rs. 44.55 billion and Rs. 123.87 billion have been allocated to the provincial and local levels, respectively.⁴⁶

The PEFA report 2015 has awarded an overall rating of C+

The PEFA report states that the allocation of transfers is not a transparent process and no complete information is available on the timeliness of transfers from the Ministry of Finance to the sub-governmental level. The report assigns a high risk to this parameter since the open sources do not provide complete transparency on the parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Transfer of cash resources	High Risk	Cash transfers from central/regional level to project level takes	The open sources do not provide transparency on timelines for transfer of cash resources from central level to local level.

⁴⁴ International Budget Report – 2019/20

⁴⁵ International Budget Report – 2019/20

⁴⁶ International Budget Report – 2019/20

		more than a month	Hence the report assigns high risk to this parameter.
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h) Reporting of cash and asset position to government

The reporting of cash and asset position is an important aspect as institutions try to attain transparency within the economy and curtail corruption, tax evasion and money laundering. The ethical adherence to the process of reporting of cash and asset position is of utmost importance as it creates the basic foundation of an ethical set-up wherein the government, the public and private sector can utilize resources in an ethical and efficient manner.

The analysis finds that;

As per the PEFA Report, The Government is using cash basis of accounting for the purpose of preparing annual financial statements covering expenditure and revenue under single financial statements. The recording of asset information is not yet mainstreamed, but asset record-keeping is practiced in selected departments of a few ministries. While data is recorded and accounts are generated, the Government has yet to compile whole-of-the government accounts or consolidated financial statements in accordance with Nepal Public Sector Accounting Standards (NPSAS), based on International Public Sector Accounting Standard (IPAS), which requires consolidation of the transactions of controlled entities, in part, financial cash reporting. This has not yet happened. Since 2008, No change in performance but Government has introduced software called Public Asset Information System, but it is yet to be mainstreamed.⁴⁷

As per the Open Budget Index, 2017, EBP documentation does not include a list of financial assets and their estimated values. It is not reflected because Government of Nepal is not preparing balance sheet anymore. Nepal government is practicing cash based accounting system not the accrual system so that the liabilities and properties are not clearly reflected in the government budget documents. The SAI has recommended the government adopt accrual-based accounting system. Relevant information presented in the Budget Speech is for revenues received, which includes some references to interest and dividend income, but again without a clear and definite identification of these receipts being derived from financial assets.⁴⁸

Cash balances are calculated daily with some lapses. Major cash balances are calculated weekly and are reflected in the weekly Treasury Report that gives budgetary cash expenditure, revenues, foreign grant, loan, cash accounts of local authorities, and financing balance. The TSA rollout has also enabled the Government to centralize the payment function at DTCOs and strengthened cash management by closing down 13,717 bank accounts. The system can now support the compilation of consolidated cash flow statements for individual ministries as well as for the central government. However, expenditure incurred by local bodies' from their own sources of revenue (about 2 percent

⁴⁷ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

⁴⁸ International Budget Report - 2017

of the total central revenue) and extra-budgetary expenses are still outside the TSA recording system.⁴⁹

The report finds that although the budget execution reports are detailed and well reported by the MoF, the details of financial assets are not incorporated in the budget. Cash position is reported but with some lapses. Since the TOR parameter looks at cash and asset position made to the Government as a defining concluder, the report assigns a high risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Reporting of cash and asset position to government	High Risk	Analysis of cash and asset position made to government contains significant omissions.	There is an absence of reporting of financial assets as part of the budget execution reports.

⁴⁹ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

3. The Audit Framework

This section deals with the overall functioning of the Supreme Audit Institution (SAI), considering factors such as accountability, efficiency, transparency, representativeness as well as adherence to the overall accepted global standards.

Supreme Audit Institutions (SAI) play an important role in strengthening public sector institutions by confirming that controls are operating effectively, identifying waste and suggesting ways in which government organizations can operate better.

The next sections predominantly looks at the overall functioning of the SAI.

a) Financial Audit/ SAI Auditor General

Under the Article 241 of the Constitution of Nepal, the Auditor General (AG) has been mandated to carry out the audits of all government offices of the federation and states, local levels and other institutions in accordance with the methods as prescribed by law with due regard to, inter alia, the regularity, economy, efficiency, effectiveness and the propriety thereof; and all Constitutional Bodies are required to submit their annual reports to the President in accordance with the Article 294 of the Constitution.⁵⁰

The objective of audit was to provide appropriate conclusions & recommendations with assurance on the following matters, by examining with due consideration to regularity, economy, efficiency, effectiveness and propriety thereof pursuant to acquisition and utilization of public resources, and give reasonable assurances on the financial statements:

- The accounts of Consolidated Funds of all three tiers consisting of federation, provinces and local levels, Contingent Funds of federation and provinces, and other government funds present real picture,
- Financial statement has been prepared in the prescribed formats and transactions are presented in true and fair manner,
- Expenditure has been incurred only for the very purpose and specified task within the limit approved for as set by Appropriation Act,
- All receipts including revenue are properly collected and deposited,
- Adequate arrangements have been made for maintaining records of government property, its usage and safeguarding,
- Arrangements for internal control and internal audit are effective,
- Financial transactions are conducted complying with laws and supporting evidences have been sufficiently maintained,
- The progress is achieved as per the program within the specified time frame,

- Services have delivered by the public entities as specified,
- Accountability and responsibility have been assumed and economy has been maintained while incurring expenditure.⁵⁰

Audits have been carried out to the financial transactions of fiscal year 2017/18 (2074/75) of constitutional bodies, all Government Offices of Federation and Provinces, Local Levels, Corporate Bodies, Committees, Boards, Trust/Funds, Authorities and Universities, and other institutions as prescribed by law, and the audit backlogs of prior fiscal years to the extent the accounts of which submitted. The financial audit as well as the performance, environmental, disaster management & sustainable development, information & technology and special audits have been carried out in conformity with the approved annual audit plan. While assessing to service delivery and other necessary subject matters by the audit, data and information have been obtained up to the audit period.

The Office has adopted internationally developed the Quality Management Framework for a Supreme Audit Institution. This framework includes the arrangements in pursuant to promoting of the auditors' independency, enhancing auditors' professional knowledge and skills continuously by hiring the capable & competent staffs, developing the auditing standards & guidelines, and audit execution & reporting by preparing annual plan. The audit works have been supervised by senior-level officials on every phase of audit, and monitoring are being carried out in respect to adherence to code of Ethics and internal control activities. With maximum use of available office resources and maintaining work-relationship with the stakeholders, a system of communicating the audit results has been established for the improvement of public financial management⁵¹

The audits cover 95 percent of total expenditures of Government offices and more than 90 percent of the autonomous bodies, development committees, district development committees, and other organizations.⁵²

As per the OAGN, The OAGN recognizes a need to address three key challenges in public audit function. These are:

- (a) Deepening knowledge and coverage of new International Organization of Supreme Audit Institutions (INTOSAI) standard compliant methodology,
- (b) Strengthening quality assurance and audit follow-up function, and
- (c) Providing new local-level audit requirements. The Supreme Audit Institutions (SAI) PMF report 2014 notes that specific interventions must address these challenges. The new

⁵⁰ The Auditor General's Fifty-Sixth Annual Report 2019 Summary Report

⁵¹ The Auditor General's Fifty-Sixth Annual Report 2019 Summary Report

⁵¹ The Auditor General's Fifty-Sixth Annual Report 2019 Summary Report

⁵² 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

federal structure presents opportunities and challenges to develop an engagement that is anchored in the shift underway in the country's political history.⁵³

There is comprehensive coverage of major public expenditure and revenue items in the internal audit coverage as defined. The OAGN covers 90 to 95% of the total expenditure and is comprehensive. Hence, the report assigns a moderate risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Financial audit / SAI auditor general	Moderate risk	External audit covers 90% of central government expenditures.	90% of autonomous bodies are covered and 95% of expenditure.

b) SAI Independence

One of the key features for the success of any institution is the reporting structure. The necessary condition for proper functioning of the auditor is that it should be independent in its decision making and also report to the parliament (or some other independent body apart from the government in a democratic structure so that it doesn't have any influence of the ruling party or people on the audit decisions).

According to the Interim Constitution 2063(2007), on the recommendation of the Constitutional Council, the President appoints the Auditor General. The functions, duties and powers of the Auditor General are specified in the Interim Constitution.⁵⁴

The Office has adopted internationally developed the Quality Management Framework for a Supreme Audit Institution. This framework includes the arrangements in pursuant to promoting of the auditors' independency, enhancing auditors' professional knowledge and skills continuously by hiring the capable & competent staffs, developing the auditing standards & guidelines, and audit execution & reporting by preparing annual plan. The audit works have been supervised by senior-level officials on every phase of audit, and monitoring are being carried out in respect to adherence to code of Ethics and internal control activities. With maximum use of available office resources and maintaining work-

⁵³ Terms of Reference – Office of the Auditor General of Nepal

⁵⁴ The official Portal of Government of Nepal- Office of Auditor General

relationship with the stakeholders, a system of communicating the audit results has been established for the improvement of public financial management. ⁵⁵

As per the Audit Act, 1991, The Auditor General shall submit its annual audit report, including his/her comments and opinions thereon, to president on the final audit of Government Offices and other offices and organization prescribed by prevailing laws, which are subject to audit by the Auditor General. President shall forward the Report received pursuant to Sub- section (1) to the legislative -parliament. ⁵⁶

The Auditor General submits an annual report with observations and recommendations to the parliament through the president. Audit reports are submitted to legislature within 12 months of end of period covered. ⁵⁷

The Auditor General may, subject to the Constitution of Nepal, 1990 and the prevailing laws, issue directives to the concerned Government Offices, and Corporate Bodies wholly or substantially owned by Government of Nepal, from time to time to make proper arrangements on matters of accounts and to maintain regularity therein. It shall be the duty of the concerned offices or organizations to abide by such directives. ⁵⁸

As per the Constitution of Nepal, it is evident that an independent reporting framework has been defined for the Auditor – General. The Auditor – General reports to the Parliament via submission of the report to the President. The report assigns a low risk to this factor.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
SAI independence	Low Risk	SAI reports to legislature (or equivalent justice system).	The internal audit function reports to the Parliament.

c) Audit standards applied by the SAI

The efficacy of the SAI is also dependent on the audit standards being followed by the institution. The SAI is a member of INTOSAI, which has provided an institutionalized

⁵⁵ The Auditor General's Fifty-Sixth Annual Report 2019 Summary Report

⁵⁶ Audit Act of Nepal, 1991 – Annual Report

⁵⁷ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

⁵⁸ Audit Act of Nepal, 1991 – Power to Issue Directives

framework for supreme audit institutions to promote development and transfer of knowledge, improve government auditing worldwide and enhance professional capacities, standing and influence of member SAIs in their respective countries. INTOSAI is an autonomous, independent and non-political organization. The factors to be focused on in this part of the current section is the relevance, standard, viability and transparency of the accounting standards adopted by the SAI.

As per the Audit Act, 1991, the Auditor General may conduct final audit of the financial activities and other activities relating thereto of the offices, bodies or organizations under its jurisdiction, either in detail or sporadically or a random basis and present the facts obtained therefrom, make critical comments thereon and submit its reports.⁵⁹

As per the Auditor – General’s Annual Summary Report, 2018, The Constitution of Nepal mandates the Auditor General to conduct the statutory audit of all government offices of federation, states & local levels, and wholly-owned corporate bodies by federal or state government in consideration with regularity, economy, efficiency, effectiveness and propriety thereof. This Fifty-fifth Annual Report has been prepared, within almost 11 months of the tenure after assuming office as an Auditor General, incorporating the findings and recommendations witnessed on this year’s (2016/17) audits of financial transactions of 6 thousand 616 entities and the audit backlogs of prior to this fiscal year. In the course of the audits and in the preparation of audit reports, the practices adopted by this office in the past, international practices, and standards adopted by International Organization of Supreme Audit Institution (INTOSAI) and Asian Organization of Supreme Audit Institution (ASOSAI) have been followed.⁶⁰

In 2017 July, a team of this office also participated in the meeting conducted on the topic 'Audit of Implementation Preparation Plan of Sustainable Development Goals' organized by United Nations Federal Department and INTOSAI Development Initiative in United Nations Head Quarter. The participation at Deputy Auditor Generals level was made from this office in 'United Nations and INTOSAI Symposium on Open Data and Data Analysis and Implementation of Sustainable Development Goals' held in Vienna Austria in 2017 May, 'Workshop on Public Administration' organized in China in 2017 September, and Seminar and Working Group Meeting on 'Seventh Environmental Audit' organized by Asian Organization of Supreme Audit Institutions held in Thailand in 2018 January.⁶¹

The Office of Auditor General (OAG) conducts financial and regularity audits on a majority of government revenues and expenditures using INTOSAI-based standards and submits audit reports through the President within four months of submission of the financial statements.⁶²

⁵⁹ Audit Act of Nepal, 1991 – Methods of Audit

⁶⁰ Office of the Auditor – General – Annual Summary Report 2018

⁶¹ Office of the Auditor – General – Annual Summary Report 2018

⁶² 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

The Office of the Auditor – General has conducted auditors as per internationally recognized standards of INTOSAI and ASOSAI. It is a consistent practice as noted from the past PEFA reports. Hence, this report assigns a low risk to this parameter

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Audit standards applied by the SAI	Low Risk	SAI applies international audit standards.	The OAGN has been following internationally accepted audit standards for submission of its reports.

d) Follow-up action to audit reports

Apart from auditing public accounts, the SAI is also responsible in providing its opinion as well as suggestions to increase the efficient use of public funds. This requires for the SAI to be independent and empowered to ensure efficient follow-up actions to its observations and remarks. This section tries to shed more light on whether follow-up actions are properly implemented with regard to observation and remarks made by SAI.

The Constitution of Nepal mandates the Auditor General to conduct the statutory audit of all government offices of federation, states & local levels, and wholly-owned corporate bodies by federal or state government in consideration with regularity, economy, efficiency, effectiveness and propriety thereof.⁶³

As per the audit summary report, Audit recommendations should be implemented, irregularities are to be timely settled and monitoring are to be carried out for the improvement of weak accountability situation owing to non-accomplishment of the conferred responsibilities by the chief accountability officers and responsible persons in effective manner. The Action Plan of Auditor General (2017-2023) has been prepared by covering special reform areas of the office's - independency, audit methodology and procedure to be adopted by the office, internal controls and governance, physical infrastructure, human resource management and relations with stakeholders after making assessment on the internal and external environment.⁶⁴

The Financial Procedures Act requires OAG to conduct follow-up on the implementation of audit report observations and recommendations. As provisioned by the Financial Procedures

⁶³ Office of the Auditor – General – Annual Summary Report 2018

⁶⁴ Office of the Auditor – General – Annual Summary Report 2018

Act 1998, the Irregularity Clearance Evaluation and Monitoring Committee formed under the chairmanship of Chief Secretary is responsible for follow-up.⁶⁵

This committee has been working consistently to follow up on audit observations to clear audit observations /irregularities. Follow-up of irregularities is at about 50 percent of audit observations so there is room for improvement. With regard to performance, a separate follow-up audit is conducted to ensure that audited entities properly address the OAG observations and recommendations. The OAG is a constitutional body but facing weak follow-up of its recommendations by the PAC.⁶⁶

In conclusion, timely and evidence based response is made, and there is a regular mechanism for follow-up but focused on clearing irregularities rather than focusing on system reform.⁶⁷

PEFA has assigned a score of C to this parameter.

The committee undertakes follow-up of recommendations issued by the OAGN. The implementation can be greatly improved from 50%, hence this report assigns a significant risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Follow-up action to audit reports	Moderate Risk	Points raised by external audit are always followed up. In a few cases points recur in following years	Audit follow up has been defined adequately, but implementation can be improved.

e) Transparency of audit reports

Audit team or auditor of the respective department of the COA is responsible to report on the result of audits conducted, comments, conclusions, recommendations on contents audited. Transparency is described as method of trying to establish how often are external audit reports published and debated in the media.

As per the OBI, The OAG conducts all 3 types of audits - compliance, financial and performance. The SAI has conducted all three types of audits (compliance, financial, or

⁶⁵ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

⁶⁶ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

⁶⁷ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

performance) and made them available to the public. Compliance and financial audit procedures are demonstrated by the OAGs main annual audit report. Based on consultations with Ministry of Finance officials, there is a Central Committee of Monitoring and Evaluation for Errors Clearance within the Ministry of Finance, They periodically produce relevant reports, with specific reference a report on progress in resolving the arrears of all ministries, a recommendation identified by the Auditor General's audit report.

⁶⁸

The Public Accounts Committee (PAC) of the Legislature - Parliament examines the audit report published by OAG on Mid-April every fiscal year. The annual audit report is submitted to President which she sent to Prime Minister. The Finance Minister on behalf of the Executive presents annual audit report to Parliament. PAC examines and conducts hearing on the audit report amid Secretary of the concerned Ministry, OAG representatives, Lawmakers and Media. The public hearing is free for media. During the discussion on audit report senior officials of OAG including Auditor General, Assistant Auditor General and Deputy Auditor General took part and testify in hearings of the Legislative committee i.e. PAC, however there is no record. Also, no public hearing on the Audit Report is held. ⁶⁹

As per the PEFA report for 2015, rating of D has been assigned, stating, examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. ⁷⁰

The audit reports are discussed in public but no input is invited from them, irrespective of significance. The audit reports are available to the public for review and meets the minimum transparency standards and captures the recommendations as well. Hence, the report assigns a moderate risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Transparency of Audit process	Moderate risk	All statutory external audit reports are published. They are usually debated in the media when of public interest.	Audit reports are discussed but not debated in public. However, they are available for review on the OAGN website.

⁶⁸ Open Budget Index – Nepal - 2017

⁶⁹ Open Budget Index – Nepal - 2017

⁷⁰ 2015 Public Expenditure and Financial Accountability (PEFA) – Nepal - PFM Performance Assessment Report

f) Staff qualifications and skills

Even with the best of intentions and the best of policies, the direction and implementation of these policies largely depends on the ability of the staff in charge of them. The qualification and skill of the staff in enhancing governance and accountability in public resources, form a critical part of the overall vision and the ability to realize this vision.

The Auditor-General of Nepal is Mr Tanka Mani Sharma (Dangal) who has a Master's degree in Business Administration. His prior positions include Secretary at the Office of the Prime Minister and Council of Ministries, Ministry of General Administration and Public Procurement Monitoring Office. Likewise he had served as a Director General of Inland Revenue Department, Department of Custom and Department of Revenue Investigation.⁷¹

However, since no details on the list of auditors apart from the Auditor – General is available in the public domain and various reports referred by us, it is not possible to determine the qualifications and skill sets of the audit function and hence we are unable to assign a risk to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Staff qualifications and skills	-	Unable to assign risk	There is a lack of information on the team and their qualification skills apart from the Auditor General.

⁷¹ Profile of the Auditor – General - Nepal

4. Financial stability

In recent years, with increased globalization, the financial sectors of economies are highly integrated and its stability has become important in term of effecting smooth functioning of the economy. With this background, the report tries to analyse and assess the current scenario of the financial sector in Nepal.

a) Financial systems

Nepalese financial system has been regulated by different regulators in the sectors of banking, insurance, securities market, contractual saving institutions and other service sectors. NRB, as the central bank, regulates commercial banks, development banks, finance companies, micro finance financial institutions, FINGOs and co-operatives carrying out limited banking activities.⁷²

As of mid-July 2018, the total number of banks and financial institutions stood at 151 comprising commercial banks 28, development banks 33, finance companies 25 and micro-finance development companies 65.⁷³

Banking sector has been dominating the financial system of Nepal. The share of banks and financial institutions in total assets and liabilities of the financial system stood at 77.68% in mid-July 2018. NPL of BFIs stood at Rs.38.51 billion in mid-July, 2018 compared to Rs.36.10 billion in mid-July 2017. In terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2018 indicating the banking sector's resilience in large.⁷⁴

Banking sector has been dominating the financial system of Nepal. The share of banks and financial institutions in total assets and liabilities of the financial system stood at 77.68% in mid-July 2018. The total assets and liabilities size of BFIs have continued to increase. As of mid-July 2018, total assets of BFIs increased by 18.81 percent to Rs.3575 billion compared to Rs. 3009 billion a year ago. Though moratorium has been placed on the licensing of new BFIs, there has been significant expansion of the balance sheet of BFIs mainly due to the increase in deposits and credits.⁷⁵

As of mid-July 2018, the five large commercial banks (LCBs) collectively accounted for 25.05 percent of total banking system assets and 28.85 percent of total commercial bank assets. This implies a high concentration of banking assets to few banks in Nepal. The

⁷² Financial System Performance and Stability – Nepal Rastra Bank - July 2018

⁷³ Financial System Performance and Stability – Nepal Rastra Bank - July 2018

⁷⁴ Financial System Performance and Stability – Nepal Rastra Bank - July 2018

⁷⁵ Financial System Performance and Stability – Nepal Rastra Bank - July 2018

failure of any of these large banks is, therefore, likely to have a large impact on the financial stability of Nepal.⁷⁶

As per the IMF Report, directors considered that monetary policy should be tightened, including to support the exchange rate peg to the Indian rupee. They noted that the recently initiated review of the central bank act provides an important opportunity to strengthen the central bank's operational autonomy and accountability. They concurred that banks should be encouraged to build additional capital and provisioning buffers against potential losses, and financial sector oversight and regulations should be further strengthened.⁷⁷

The Nepal Rastra Bank (NRB) reports the Standardized Report Forms (SRFs) 1SR for central bank, 2SR for other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's International Financial Statistics on a monthly basis with a lag of about one month. However, there are some inconsistencies in the reporting of positions between the NRB and the ODCs. Minimizing these will further improve data quality.⁷⁸

The financial integrity of Nepal is stable as reflected in the data. There are some data reporting issues that have been noted in the financial system due to which a moderate risk has been assigned to this parameter.

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Financial systems	Moderate risk	Financial systems are adequate for most but not all data capture and reporting needs. They are reliable and properly maintained.	The financial integrity of Nepal is stable as reflected in the data. The monetary policy is required to be strengthened to improve the autonomy of the central bank.

b) Environmental conditions

Major events such as natural calamities like floods, cyclones, earthquakes etc. greatly affect the socio-economic fabric of a country. These are external factors that play a pivotal role in the overall well-being of any citizenry. Hence, to understand the overall quality of life within the country, it is imperative to look at this parameter.

⁷⁶ Financial System Performance and Stability – Nepal Rastra Bank - July 2018

⁷⁷ IMF – 2019 Article IV Consultation – Nepal

⁷⁸ IMF – 2019 Article IV Consultation – Nepal

Due to its rugged topography, ecological adversity, prevalence of a number of flood-prone rivers, rapid and unplanned urbanization, poverty, inequality and uneven development, Nepal is exposed to a variety of natural and man induced disasters. More than 80 percent of the total population of Nepal is at risk from natural hazards, such as floods, landslides, windstorms, hailstorms, fires, earthquakes and Glacial Lake Outburst Floods. Nepal is also in a seismically active zone with a high probability for massive earthquakes. All these factors place Nepal among the 20 most disaster prone countries in the world.⁷⁹

A review of disaster data for last the 45 years indicates that the incidences of disasters are growing every year in Nepal. Nepal is one of the countries in South Asia where 'affect to killed ratio' due to disaster is high. Globally, Nepal ranks 4th and 11th in terms of its relative vulnerability to climate change and earthquakes, respectively.⁸⁰ Out of a total 6,381 disaster incidents as per National Emergency Operation Center (NEOC) records in 2017-18, have claimed the lives of 968 people and 3,639 left with injuries. The estimated property loss of these disasters accounted approximately NPR 6.84 billion.⁸¹

The Constitution of Nepal has identified disaster management as one of the key priorities of all tiers of government. To meet the vision of the Constitution, a comprehensive DRRM Act, 2017 was endorsed by the Government. The Disaster Risk Reduction and Management (DRRM) Act, 2017 provides a comprehensive outlook to capture different dimensions of disaster risk management (DRM). The DRRM Act is more progressive in encouraging a proactive approach in reducing and managing disaster by introducing the 'whole of society approach' in disaster risk management and ensuring ownership an accountability.⁸²

The Sendai Framework for Disaster Risk Reduction outlines the below mentioned priorities:

- **Understanding Disaster Risk:** Gathering and developing comprehensive risk information, based on technically-sound risk assessments remain a challenge. Reviews of a few Local Disaster Risk Management Planning (LDRMPs) and Local Adaptation Plan of Actions have shown that they are not based on a comprehensive understanding of risks. Despite the challenges, the Ministry of Home Affairs (MoHA) has still engaged with various agencies to develop methods for conducting risk assessments.
- **Strengthening Disaster Risk Governance to Manage Disaster Risk:** The newly endorsed Disaster Risk Reduction and Management Act (2017) has been formulated to address disaster risk management with a comprehensive approach, focusing on different stages of disaster management cycle. Yet, gaps remain even within the new legislative framework. Conflicting provisions of Acts have created overlapping roles and responsibilities. The policy formulation and institutional set-up need to be complemented with enhanced ability and competence in implementation to operationalize the intent of the relevant acts and policies at all levels of government.
- **Investing in Disaster Risk Reduction for Resilience:** Nepal's commitments in investing in DRR were expressed in the language of planning documents. Public

⁷⁹ Nepal Disaster Report – December 2017

⁸⁰ Nepal Disaster Report – December 2017

⁸¹ Nepal Disaster Report – December 2017

⁸² Nepal Disaster Report – December 2017

expenditure for disaster preparedness and mitigation is channelled through government line agencies for DRR projects and programs. About five percent of the total capital expenditure of the government currently spent in DRM is insufficient given the scale of disasters in the country, and sectoral allocation for DRM is still very marginal compared to the actual needs.

- **Enhancing Disaster Preparedness for effective Response to “build back better” in recovery, rehabilitation and reconstruction:** The National Disaster Response Framework covers preparedness and emergency response at national, regional, district and local level using tiered structure.⁸³

Substantive progress has been achieved towards establishment of the NDRRMA. It is equally important to ensure that there is coherence among the policies and their subsequent implementation. A close and proactive engagement of all tiers of governments and related stakeholders needs to be further strengthened to this end. Management of DRR related information, its accumulation, establishing common platform and ensuring access to all is a key concern, to address this crucial requirement, Disaster Information Management System needs to be institutionalized at all tiers of government.⁸⁴

Nepal is a high risk nation for natural disasters including earthquakes which are frequent and disastrous. It has developed a disaster management plan but implementation may not mitigate the risks to the full extent. The report assigns a high risk to the parameter

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Environmental Conditions	High Risk	Natural disasters or significant events regularly occur that displace citizens and resources	The increased risk of natural disasters along with improvements required in the disaster management plan account for a high risk

c) Exchange rate volatility

The exchange rate arrangement of Nepal is a conventional peg to a single currency unit. The Nepalese rupee is pegged to the Indian rupee at a rate of NRs 1.6 per Indian Rupee. Currently, all merchandise imports (except for a few goods restricted for security or related reasons) are freely available through an open general license system, with foreign exchange provided through the banking system at the market exchange rate.⁸⁵

⁸³ Asian Disaster Preparedness Centre - Nepal Disaster Risk Reduction 2019

⁸⁴ Nepal Disaster Report – December 2019

⁸⁵ IMF – 2019 Article IV Consultation – Nepal

The corresponding cross exchange rates are provided in the table below;⁸⁶

Currency	US Dollar (Buying)
December 31, 2019	113.81 NPR
December 31, 2018	111.61 NPR
December 31, 2017	101.9 NPR
December 31, 2016	108.31 NPR

The average year on year real effective exchange rate change was 6% for 2015-16, 3.3% for 2016-17 and (0.1)% for 2017-18.⁸⁷

Nepal's external position in 2017/18 was moderately weaker than the level consistent with medium-term fundamentals and desirable policy settings. The weakness of the current account and overall balance of payments has become more pronounced in the first 5 months of 2018/19. In the short term, improving the external position requires tighter fiscal and monetary policies. Medium-term policies need to focus on improving the business climate and productivity and competitiveness. These are also needed to maintain reserve adequacy and support the peg to the Indian rupee which continues to serve Nepal well.⁸⁸

The current account deficit widened sharply to 8.2% of GDP in FY 2017-18 due to strong import demand and higher oil prices. Nepal's central bank reserves, which peaked at USD 9.5 billion in January 2018 on the sustained strength of remittances, fell to USD 8.3 billion in December (6 months of prospective imports) but are still well above reserve adequacy metrics applied to Nepal. External debt remains low and Nepal has a positive International Investment Position (10.6% of GDP).⁸⁹

They highlighted that the level of foreign exchange reserves remained comfortable and expected strong remittance inflows and efforts to mobilize external resources to help finance the large trade deficit. The closed capital account, the peg to the Indian Rupee (INR) and the large share of trade with India have limited the spill overs from the recent increased INR volatility.⁹⁰

As per the IMF Report, 2019, the monetary policy is required to be strengthened in the short term to close majority of the current account gap which would also safeguard and support the

⁸⁶ Nepal Rastra Bank – Forex Graph

⁸⁷ IMF – 2019 Article IV Consultation – Nepal

⁸⁸ IMF – 2019 Article IV Consultation – Nepal

⁸⁹ IMF – 2019 Article IV Consultation – Nepal

⁹⁰ IMF – 2019 Article IV Consultation – Nepal

pegging of the exchange rate to INR which has helped to act as a buffer against external headwinds and pressures. Hence, the report assigns a low risk to this factor

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Exchange rate volatility	Low Risk	Foreign exchange rates do not fluctuate significantly.	The pegging of the currency to INR has helped stabilize the exchange rate along with favorable trade positions.

d) Existence of a black market

The Corruptions Perception Index (CPI) by Transparency International 2019 for Nepal ranked the country 113/180 with a score of 34/100. The global average score is 43 which shows that Nepal ranks below average as compared to its peers.⁹¹

- Organ Trafficking:** The recent trend of human trafficking in Nepal shows increasing and complex dynamics among different forms of trafficking, particularly those related to the extraction of human organs. While Nepal's legal framework accepts the extraction of organs as an act of trafficking except as provided for by the law; organ trafficking remains under-reported and eludes conventional state intervention. Sixty-six respondents, more than one in four overall (27.4%), said they knew a neighbour or relative who had sold a kidney. This proportion was highest among Dalits (53.2%), followed by Janjatis (28.1%) and Brahmin Chhetris (14.3%).⁹²
- Illegal trade in wildlife:** While the country is not regarded as a primary consumer of wildlife, much of South Asia's wildlife trade moves through Nepal to markets in East Asia (Shakya, 2004). The trade in otters is chiefly known for because their pelts are often sold alongside other high-value wildlife products, such as tiger skins.⁹³
- Human Trafficking:** Cases of human trafficking in Nepal occur in many areas like: entertainment, hospitality, brick kiln, and garment industries, in agricultural and domestic work, street begging, and transplantation of organs. Human trafficking remains the most

⁹¹ Corruptions Perception Index 2019

⁹² Kidney Trafficking in Nepal - 2015

⁹³ TRAFFIC bulletin – Otters – Nepal - 2018

profitable illegal tread. Annually women and children are trafficked across international border and trafficked within country.⁹⁴ Nepal is a party to three anti trafficking conventions: the 1926 Slavery Convention, the 1956 Supplementary Convention on the Abolition of Slavery, and the 1949 Convention for the Suppression of the Traffic in Persons and of the Exploitation of the Prostitution of Others. The number of trafficking cases registered in Nepal Police increased from 185 in FY 2013/14 to 305 in FY 2017/18.⁹⁵

There is a greater shift in trafficking dynamics in Nepal. In the past, Nepal was basically a source country for trafficking of children and women to prostitution to India. Now, Nepal has emerged as source-transit-destination country of trafficking. Broadly, three types of trafficking emerge: cross-border (to India), cross-border (to outside of India and mostly to Gulf countries) and internal trafficking.⁹⁶

Despite strong legal provisions prohibiting drug consumption, possession, and transport, drugs are openly sold in Kathmandu, especially in areas frequented by tourists. Although Nepal is neither a significant producer of nor a major transit route for narcotic drugs, domestically produced cannabis, hashish, and heroin are trafficked through Nepal every year.⁹⁷

The United States' (US) Trafficking in Persons (TIP) Reports provide an indication that to what extent Nepal has been compliance with the US Government minimum standards of Trafficking Victims Protection Act. Nepal has been placed in Tire 2 over the last 5 years. Nepal's situation appears to be satisfactory compared to other South Asian countries like Afghanistan, Bangladesh, Maldives and Pakistan.⁹⁸

According to the US TIP Report 2018, the GoN during the reference period, increased the trafficking investigations and identification of the victims, and it revoked the licenses of more than 400 foreign employment agents in 2018. Despite these efforts, the Government of Nepal did not meet the minimum standards in several areas like prohibition of all forms of forced labour and sex trafficking, no serious protection for male migrant workers. Official involvement in trafficking offenses is frequently reported and is a serious problem due to their direct involvement in trafficking crimes and their negligence on the part of monitoring.⁹⁹

The analysis finds that Nepal is under heavy influence of black market which needs to be targeted with the help of a strengthened monitoring process.

⁹⁴ National Human Rights Commission (NHRC) – Sept 2018

⁹⁵ National Human Rights Commission (NHRC) – Sept 2018

⁹⁶ National Human Rights Commission (NHRC) – Sept 2018

⁹⁷ Overseas Security Advisory Council (OSAC) – Nepal – Crime and Safety Report

⁹⁸ National Human Rights Commission (NHRC) – Sept 2018

⁹⁹ National Human Rights Commission (NHRC) – Sept 2018

Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
Existence of black market	High Risk	Black market is prevalent and influential in the country.	There is a strong prevalence of black market and strong reforms are required to tackle the same.

5. Conclusion

The table below provides a summary of the overall risk parameters for Nepal;

Sr. No.	Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
1.	The annual budget contains all significant government expenditures, including relevant donor contributions	Low risk	No	The budget is very detailed and provides in depth bifurcation of revenue and expenditure amounts including donor contributions.
2.	Budget and performance	Low risk	Budget decisions are fully debated with assistance from expert committees. Full consideration of previous performance is taken into account when setting future budgets.	The budget is well discussed in the Parliament and debated. Analysis of revenue and expense is carefully considered at the time of budget preparation.
3.	Budget execution	Moderate risk	Government historically executes budgets as planned with limited exceptions.	Although the budget execution rates are very high, they are not without exceptions and have scope for further improvement
4.	To what extent are internal controls and financial procedures adhered to	Significant Risk	Procedures are generally followed, but there are significant exceptions. Doubt exists as to whether or not the internal	The internal control procedure framework is designed but can be further strengthened to be effective.

Sr. No.	Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
			control system can be relied upon.	
5.	Bank Reconciliations	Significant risk	A number of significant accounts are not reconciled monthly. Quality is sometimes poor	Bank reconciliations for some bank accounts are not prepared. We are not able to ascertain whether follow up actions are taken in all cases.
6.	Country has a national procurement framework	Low Risk	Yes	The country has a robust procurement framework including robust agency to monitor expenditures.
7.	Transfer of cash resources	High Risk	Cash transfers from central/regional level to project level takes more than a month	The open sources do not provide transparency on timelines for transfer of cash resources from central level to local level. Hence the report assigns high risk to this parameter.
8.	Reporting of cash and asset position to government	High Risk	Analysis of cash and asset position made to government contains significant omissions.	There is an absence of reporting of financial assets as part of the budget execution reports.
9.	Financial audit / SAI auditor general	Moderate risk	External audit covers 90% of central government expenditures.	90% of autonomous bodies are covered and 95% of expenditure.

Sr. No.	Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
10.	SAI independence	Low Risk	SAI reports to legislature (or equivalent justice system).	The internal audit function reports to the Parliament.
11.	Audit standards applied by the SAI	Low Risk	SAI applies international audit standards.	The OAGN has been following internationally accepted audit standards for submission of its reports.
12.	Follow up action to audit reports	Moderate Risk	Points raised by external audit are always followed up. In a few cases points recur in following years.	Audit follow –up has been defined adequately, but implementation can be improved.
13.	Transparency of Audit process	Moderate risk	All statutory external audit reports are published. They are usually debated in the media when of public interest.	Audit reports are discussed but not debated in public. However, they are available for review on the OAGN website.
14.	Staff qualifications and skills	-	Unable to assign risk	There is a lack of information on the team and their qualification skills apart from the Auditor General.
15.	Financial systems	Moderate risk	Financial systems are adequate for most but not all data	The financial integrity of Nepal is stable as reflected in the data. The monetary

Sr. No.	Performance Indicator	Risk assessment	Definition of Risk Assessment as per the checklist given.	Remarks
			capture and reporting needs. They are reliable and properly maintained.	policy is required to be strengthened to improve the autonomy of the central bank.
16.	Environmental Conditions	High Risk	Natural disasters or significant events regularly occur that displace citizens and resources	The increased risk of natural disasters along with improvements required in the disaster management plan account for a high risk
17.	Exchange rate volatility	Low Risk	Foreign exchange rates do not fluctuate significantly.	The pegging of the currency to INR has helped stabilize the exchange rate along with favorable trade positions.
18.	Existence of black market	High Risk	Black market is prevalent and influential in the country.	There is a strong prevalence of black market and strong reforms are required to tackle the same.

6. Appendix A - Detailed definitions as per the Terms of Reference

No.	Indicator	Risk Consideration			
		High risk	Significant risk	Moderate risk	Low risk
1	The annual budget contains all significant government expenditures, including relevant donor contributions	No			Yes
2	Budget and performance	Budget decisions are only nominally debated. Little consideration of previous performance is taken into account when setting future budgets.			Budget decisions are fully debated with assistance from expert committees. Full consideration of previous performance is taken into account when setting future budgets.
3	Budget execution	Government historically does not execute budgets as planned.	Government historically executes budgets as planned, but there are significant exceptions.	Government historically executes budgets as planned with limited exceptions.	Government historically executes budgets as planned without exceptions.
4	To what extent are internal	Procedures are	Procedures are generally	Procedures are generally	Always.

	controls and financial procedures adhered to?	frequently over-ridden or ignored. Emergency procedures are routinely used.	followed, but there are significant exceptions. Doubt exists as to whether or not the internal control system can be relied upon.	followed. While exceptions exist, they are not frequent enough to prevent reliance on the internal control system.	
5	Bank reconciliations	Many accounts are not reconciled monthly. Reconciliations are often poorly performed.	A number of significant accounts are not reconciled monthly. Quality is sometimes poor.	Generally banks are properly reconciled each month. Exceptions exist but appropriate follow-up action is taken in all cases.	Performed to a high standard for all bank accounts at least once a month.
6	Transfer of cash resources	Cash transfers from central/regional levels to project level take more than one month.	Cash transfers from central/regional levels to project level take two to four weeks.	Cash transfers from central/regional levels to project level take one to two weeks.	Cash transfers from central/regional levels to project level take a week or less.
7	Reporting of cash and asset position to government	Analysis of cash and asset position made to government contains significant omissions.			Full analysis of cash and asset position is made to government.

8	Financial audit / SAI auditor general <i>*For decentralized governments, consider consolidated audit coverage, if available.</i>	External audit covers less than 80 percent of central government expenditures.	External audit covers 80 percent to 90 percent of central government expenditures	External audit covers 90 percent of central government expenditures.	External audit covers all central government expenditures.
9	SAI independence	SAI reports to government agency.			SAI reports to legislature (or equivalent justice system).
10	Audit standards applied by the SAI	SAI applies national audit standards, which are significantly inconsistent with international standards.			SAI applies international audit standard.
11	Follow-up action to audit reports	Points raised by external audit are infrequently followed up.	Points raised by external audit are usually but not always followed up. A significant number of points recur in following years.	Points raised by external audit are always followed up. In a few cases points recur in following years.	Points raised by external audit are always properly followed up. Points generally do not recur in following years.
12	Country has a national procurement framework	No			Yes

13	Transparency of audit process	Statutory external audit reports are infrequently published. They are rarely debated in the media, even when of public interest.	Most statutory external audit reports are published. They are sometimes debated in the media when of public interest.	All statutory external audit reports are published. They are usually debated in the media when of public interest.	All statutory external audit reports are published. They are debated in the media when of public interest.
14	Staff qualifications and skills	It is often unclear whether staff have the skills and qualifications necessary to discharge their duties.	In some cases it is unclear whether staff have the skills and qualifications necessary to discharge their duties.	In only some isolated cases it is unclear whether staff have the skills and qualifications necessary to discharge their duties.	It is always clear that all staff have the skills and qualifications necessary to discharge their duties.
15	Financial systems	Financial systems only capture and report on the most basic financial data, and this is frequently unreliable. System maintenance and performance is generally poor.	Financial systems only capture and report on the most basic financial data. While there are system maintenance and performance problems, generally the system is stable.	Financial systems are adequate for most but not all data capture and reporting needs. They are reliable and properly maintained.	Financial systems are adequate for data capture and reporting needs. They are reliable and properly maintained.
16	Environmental conditions	Natural disasters or significant			Natural disasters or significant

		events regularly occur that displace citizens and resources.			events that displace citizens and resources rarely or never occur.
17	Exchange rate volatility	Foreign exchange rates fluctuate significantly on a daily basis.	Foreign exchange rates fluctuate significantly on a weekly or monthly basis.	Foreign exchange rates have remained relatively consistent, with the exception of significant one-off fluctuations.	Foreign exchange rates do not fluctuate significantly.
18	Existence of a black market	Black market is prevalent and influential in the country.	Black market exists and has significant influence in the country.	Black market exists in the country, but effective actions are being taken to eliminate or limit its influence in the country.	Black market may exist but does not have an influence in the country.
19	<Any other specific items identified by agency> <i>Examples: Inflation, reliability of statistics bureau, parliamentary control, unemployment rate, transparency of</i>				

	information collection				
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