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FIDUCIARY SYSTEMS ASSESSMENT

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for
Nepal Quality Health Systems Program
Program for Results [PforR]
Fiscal Years 2022/23 - 2027/28

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Abbreviations

AARAP	Audit Arrears Resolving Action Plan
ACG	Anti-Corruption Guidelines
AWPB	Annual Work Plan and Budget
CIAA	Commission for the Investigation of Abuse of Authority
CG	Conditional Grant
CGAS	Computerized Government Accounting System
DLI	Disbursement-Linked Indicator
DLR	Disbursement-Linked Result
DOHS	Department of Health Service
DTCO	District Treasury Controller Office
e-GP	e-Government Procurement
e-WP	Electronic Working Paper
FCGO	Financial Comptroller General Office
IPF	Investment Project Financing
ISSAI	International Standards of Supreme Audit Institutions
IT	Information Technology
IUFR	Interim Unaudited Financial Report
IVA	Independent Verification Agent
LG	Local Government
LMBIS	Line Ministry Budget Information System
LGOA	Local Government Operation Act
M&E	Monitoring and Evaluation
MOEAP	Ministry of Economic Affairs and Planning
MOFAGA	Ministry of Federal Affairs and General Administration
MOHP	Ministry of Health and Population
MOF	Ministry of Finance
MTEF	Medium-Term Expenditure Framework
NAMS	Nepal Audit Management System
NCB	National Competitive Bidding
NEPSAS	Nepal Public Sector Accounting Standards
NHSMRP	Nepal Health Sector Reform Program
NNRFC	National Natural Resources and Fiscal Commission
NPC	National Planning Commission
NPR	Nepalese Rupee
NQHSP	Nepal Quality Health Systems Program
OAG	Office of the Auditor General
OPRC	Operational Procurement Review Committee
PAC	Public Accounts Committee
PAMS	Public Asset Management System
PAP	Program Action Plan
PEF	Program Expenditure Framework
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PG	Provincial Government
PIU	Project Implementation Unit
PLGs	Provincial and Local Governments
PLGSP	Provincial and Local Governance Support Program
POG	Program Operating Guideline
PPA	Public Procurement Act
PforR	Program for Results
PPMO	Public Procurement Monitoring Office
PPR	Public Procurement Regulation
PTCO	Provincial Treasury Comptroller Office
PTSA	Provincial Treasury Single Account
SNG	Sub-national Government
SuTRA	Subnational Treasury Regulatory Application
TSA	Treasury Single Account
WB	World Bank

Nepal Quality Health Systems Program (P177389)

FIDUCIARY SYSTEMS ASSESSMENT

Section 1: Conclusions

1.1 Reasonable Assurance

1. An integrated Fiduciary Systems Assessment (FSA) of the key implementing agencies in the Nepal Quality Health Systems Program (NQHSP) was conducted in accordance with the World Bank policy and related Directive concerning the Program for Results (PforR). The key implementing entities are the Ministry of Health and Population (MOHP), the Department of Health Services (DOHS), the Health Insurance Board (HIB), two Provincial Governments (PGs) - Gandaki and Koshi, and the Local Governments (LGs) under the two PGs. The FSA assessed whether the Program's fiduciary system and its performance are adequate and provide reasonable assurance that the funds would be used for the intended purposes. This would include due attention to the principles of economy, effectiveness, transparency, and accountability. There are agreed actions reflected in the proposed Disbursement Linked Indicators (DLIs), Program Action Plan (PAP) and other proposed mitigation measures that will be supported and implemented during Program implementation. Subject to timely implementation of the agreed actions to strengthen the fiduciary systems, the capacity and performance of the Program implementing agencies is considered adequate to provide reasonable assurance that the Program funds would be used for the intended purposes with due attention to the principles of economy, efficiency, effectiveness, transparency, and accountability. If any significant events and issues come to the knowledge of the team during Program implementation, additional mitigation measures shall be put into place in consultation with the implementing agencies and the Government of Nepal.

1.2 Risk Assessment

2. **Based on the assessment and the fact that the Program will be implemented at the national, provincial, and local governmental levels, the combined fiduciary risk is assessed as Substantial.** The FSA has identified key risks to which the Program may be subject to.

- a) There is a risk of inadequate budget to implement the program activities mainly due to lack of appropriate allocation of budget into the right activities rather than lack of overall budget amount. The MOHP will coordinate with the implementing agencies for preparing an Annual Work Plan and Budget (AWPB) of the Program to facilitate MoF to allocate adequate budget for the Program activities. The time schedule of preparing AWPB is defined in the budget formulation guidelines. This mitigation measure is included in the FMAP and will be included in the Program Operating Guidelines (POG).
- b) MOHP, as the main implementing agency for the Investment Project Financing (IPF) component and the main coordinating agency of the Program, is staffed with health and administration professionals who do not have the requisite knowledge and experience to manage procurement. Further, the Nepal e-Government Procurement (e-GP) system is applicable to procurement above a specified threshold and is used partially for bids publication and the opening of bids only. The capacity of staff to operate the e-GP is low, especially amongst the LGs. The MOHP will: (i) hire a procurement consultant for providing procurement support and training to the LGs on terms of reference agreed with the Bank with significant focus on capacity building of Ministry staff at all levels; (ii) make the necessary arrangements to provide training and clinics on procurement management and e-GP implementation for the LGs, including assistance from the World Bank procurement team; (iii) encourage the DOHS and the LGs to use the e-GP system for all

procurement, even for those below the threshold and coordinate with the Public Procurement Monitoring Office (PPMO) to provide training on the e-GP for its staff and for the LGs. This mitigation measure is included in the PAP. To augment transparency in procurement information disclosure, it is recommended that all contract awards under the program will be published on the MOHP website, as well as the respective government websites of all implementing entities.

- c) Non-compliance with the applicable internal control and internal audit requirements at the federal and sub-national levels is assessed as a risk. Implementation of internal control guidelines and the strengthening of the Accounts committees at the local levels, with monitoring from the MOHP and the DOHS is expected to mitigate this risk. There would be focus on internal audit to be carried out regularly with enhanced quality and coverage. These actions are included in the PAP.
- d) There is a need to strengthen the complaint handling framework and mechanism. The latest audit report for the predecessor Program for fiscal year (FY) 2020-21 issued by the Office of the Auditor General, had no serious cases of corruption reported. However, there are complaint cases as mentioned in the latest annual report of Commission for Investigation of Abuse of Authority (CIAA) (Page 334)¹ such as: a) procurement without competition; b) emergency procurement without pre-planning; c) no adequate supporting documents for payment; and so on. No follow-up report is available about the complaint cases. The MOHP has not yet developed ministry- and sector-specific codes of ethics, and the existing grievance-handling mechanism is not seen to be active. Suggested mitigation measures for handling complaint cases include an information-sharing mechanism between the MOHP and the Bank regarding corruption cases; as well as grievance-handling mechanism. This is included in the PAP.
- e) The audits for the previous Nepal Health Sector Reform Program (NHSMRP) were delayed, indicating risk for the program audit and the follow-up on the audit observations is weak at all levels. The MOHP has agreed to coordinate with the Office of the Auditor General (OAG) for timely audits; and timely follow-up of audit observations through the Accounts Committee at all levels of government, which in turn will be monitored by dedicated support units of the MOHP and the DOHS. These measures are included in the FMAP.
- f) The fiduciary staffing and capacity of the MOHP will need to be strengthened regarding procurement, financial management and contract management aspects. This can be achieved through the appropriate and timely assignment/appointment for the Program, to be followed by regular training on all fiduciary aspects (including procurement), contract management, fiduciary complaint handling, audits, program accounting, and submitting DLI claims. The training will be included in the TA component.

These key risks and mitigation measures have also been outlined in Section 4: Program Systems and Capacity Improvements.

1.2 Procurement Exclusions

3. **The Program is not expected to procure any large contracts valued at or above the Operational Procurement Review Committee (OPRC) thresholds (that is, US\$75 million for works, US\$50 million for goods and non-consulting services, and US\$20 million for consultant services), which are based on a “Substantial” risk rating.** The program will exclude any firms debarred and sanctioned by the Bank to take part in procurement processes and award of contracts under the program which will also be incorporated in the TORs for the Program audit.

Section 2: Scope

The scope of the Fiduciary System Assessment is based on the defined implementation arrangements and the Program boundary, including its accompanying Program Expenditure Framework

¹ <https://ciaa.gov.np/singlePublications/168>

(PEF). The FSA assessed the fiduciary systems of the key implementing agencies at the federal and subnational levels, as the Program includes all levels of the government.

2.1 Implementation Arrangements

4. The MOHP, the DOHS, the two PGs, and the LGs will play the key role as implementing agencies of the NQHSP. The MOHP will be responsible for overall coordination in terms of annual planning, budgeting, and implementation of the Program. A summary of key implementing entities and their fiduciary framework is outlined in Table 1.

Table 1: Summary of Implementing Entities

Particulars/Name of entity	MOHP	DOHS	Provincial government (PG) – Gandaki and Koshi	Local government (LG)	Health Insurance Board (HIB)
Nature of legal entity	Federal Ministry	Federal Department under the MOHP	Autonomous Government	Autonomous Government	Autonomous Board
Government Act	Constitution of Nepal	Constitution of Nepal	Constitution of Nepal	Constitution of Nepal	Health Insurance Act of 2017
Year established			2017	2017	2017
Governing Body	Council of Ministers	MOHP	Provincial Council	Municipal Council	Board of Directors
Executive head	Health Minister	Director General	Chief Minister	Mayor/ Chairperson	Executive Director
Linkage to Government of Nepal budget	Directly reflected in the Budget Book (Red Book)	Directly reflected in the Budget Book (Red Book)	Directly reflected in the Budget Book (Red Book) of the PG	Directly reflected in the Budget Book (Red Book) of the LG	Grant
Funds and payments	Government Treasury	Government Treasury	Provincial Government Treasury	Local Government Treasury	Own Bank Accounts
Accounting basis	Cash	Cash	Cash	Cash	Cash
Mode of accounts	Double Entry	Double Entry	Double Entry	Double Entry	Double entry
Auditor	Supreme Audit Institution of Nepal (Office of the Auditor General)	Supreme Audit Institution of Nepal (Office of the Auditor General)	Supreme Audit Institution of Nepal (Office of the Auditor General)	Supreme Audit Institution of Nepal (Office of the Auditor General)	Supreme Audit Institution of Nepal (Office of the Auditor General)
Procurement rules	Public Procurement Act of 2007 and Public Procurement Rules of 2007	Public Procurement Act of 2007 and Public Procurement Rules of 2007	Public Procurement Act of 2007 and Public Procurement Rules of 2007/ PG's own Procurement Regulation	Public Procurement Act of 2007 and Public Procurement Rules of 2007/ LG's own Procurement Regulation	Public Procurement Act of 2007 and Public Procurement Rules of 2007
Procurement arrangement	MOHP Procurement Unit	DOHS Procurement Unit	PG Procurement Units	LG procurement Units	HIB Procurement Unit
Procurement complaints	MOHP	DOHS	PG	LG	HIB

Source: Compiled by the assessment team

5. **Provincial and local governments will implement the Program according to their mandates.** The Gandaki Province has a Ministry of Health and Population, and Koshi has a Ministry of Health to

coordinate and implement the Program. The Federal MOHP issued a guideline² in July 2022 for implementing programs at the province level through conditional grants. The guideline concerning conditional grants stipulates the following: (i) health-related statistical data will be entered in the Health Management Information System (HMIS) for monitoring purposes; (ii) coordination with health sector agencies at the federal and provincial level will proceed for effective implementation of programs; (iii) additional resources will be managed from the local level in case the appropriated budget is insufficient; (iv) the allocated budget amounts will be utilized for mandatory liabilities and only for the prescribed programs; (v) programs and activities will be conducted by allocating budget only on the prescribed basis under the guidelines; (vi) the procurement laws, financial procedures and laws, and the MOF guidelines shall be followed during budget implementation, and so on.

6. The Health Insurance Board (HIB) will implement the insurance-related program activities.

The HIB is an autonomous body established under the Health Insurance Act of 2017. Its major functions are to: (i) approve and implement health insurance policy and programs; (ii) determine service standards; (iii) fix the health insurance premium payment methodology and rates; and (iv) monitor, regulate and evaluate the health insurance service providers, and so on. The technical support will be provided from the NQHSP to each of the institutions responsible for the execution and implementation of the program according to the needs of the federal structure. Separate support units for the NQHSP will be formed under the MOHP and under the DOHS. The overall program execution and monitoring will be carried out by the program support units at the MOHP and the DOHS. The following ministries and institutions were consulted during the assessment: the Office of the Auditor General (OAG); the Financial Comptroller General Office (FCGO); the MOHP; the DOHS; the HIB; the Provincial Treasury Comptroller Office (PTCO); the District Treasury Controller Office (DTCO); and health institutions at the provincial and local levels.

7. The FSA's emphasis was on those aspects of fiduciary system management that would be used for the implementation of the Program. This report integrates the findings in the areas of financial management, procurement, governance, and accountability.

The financial management system covered the federal, provincial, and local government implementation agencies focusing on the MOHP, the DOHS, the HIB, as well as the two PGs and local governments in the two provincial governments. The FSA covered the following key areas:

Financial Management

- ◆ **Planning and Budgeting:** Budget versus expenditures, budget utilization and transparency.
- ◆ **Funds Flow:** Fund flow mechanisms; the process of how funds are received at each level of government; utilization reports and how frequently they are produced; delegation of authority; fund management; and timeliness of utilization of funds.
- ◆ **Accounting, financial reporting and internal control:** Process of compiling monthly and annual accounts and preparing financial statements; accounting system used; financial standards used; current staffing structure, including minimum qualifications required; adequacy and capacity of staff; responsibilities of the accounts department; time lag in the preparation of financial statements; whether there is segregation of duty; the existence of a Fixed Asset Register; and physical verification, as well as record keeping.
- ◆ **Audit-Internal and external:** Entities responsible for auditing line agencies; the existence of internal audit; the resolution of audit observations; and time lags in conducting audits.
- Procurement system:** Regulatory framework for procurement covering the implementation agencies responsible for carrying out major program procurement and contract implementation.
- ◆ **Procurement planning:** The assessment analyzed the procurement planning; the procurement profile; the procurement systems and practices; the capacity of potential bidders; and the staff in line agencies, including contract administration. Because of its simple nature and low-value contracts, there have been no cases of dispute so far. However, contract management has been weak, resulting

² Chrome extension://efaidnbnmnnibpcajpcg1clefindmkaj/https://mohp.gov.np/uploads/Resources/1658308966526All_PIG_Province_2079-80.pdf

in time and cost overruns in many cases.

- ❑ **Governance and Accountability:** Vigilance function at each entity level; the legal framework; and the trend of complaint cases and other governance and accountability issues found in the health sector that are reported by the anti-corruption constitutional body - CIAA.

8. **The FSA assessed whether the systems and performance of the Program’s fiduciary systems are adequate and provide reasonable assurance that the funds would be used for the intended purposes, with due attention to the principles of economy, efficiency, effectiveness, transparency, and accountability.** The review relies on documents and data provided by the agencies regarding their fiduciary processes and performance, as well as their knowledge of Public Financial Management (PFM) and procurement systems gained during their experience in implementing World Bank and other projects. The Technical Assessment to the Program establishes the Program Expenditure Framework (PEF). The FSA relies on the conclusions from the Technical Assessment regarding the economy, efficiency, and effectiveness of the PEF. This FSA assessed the existence and adequacy of the Program’s fiduciary environment established through the laws, rules, and regulations governing the agencies. It also assessed the fiduciary systems in the agencies and the state of their actual implementation with a view to obtaining assurance that these systems would contribute to meeting the Program objectives. Finally, it identified the associated risks and mitigation measures.

2.2 Program Boundary and Expenditure Framework

9. **Of the US\$7.42 billion of the Government program (“p”) cost, of which the International Development Association (IDA)-supported Program has been carved out, the Program (“P”) is costed at US\$ 1.51 billion for the period of FY2024 to FY2028.** The Federal Government is the main financier of the Program, with a US\$103.84 million contribution from the World Bank. This includes an IDA concessional loan for US\$100 million and a Health Emergency Preparedness and Response (HEPR) Trust Fund Program grant of US\$3.84 million (Table 2). World Bank funding is only about 7 percent of the Program. The scope of the Program includes support for all federally funded and executed activities. These will be implemented directly by federal spending units and federally funded health conditional grants (CGs) to the two selected Provinces and Local Governments (LGs) as far as they relate to the Program results areas. These have been identified in the Program Expenditure Framework (discussed in the Technical Assessment section and in Annex 3).

Table 2: Sources of Program Financing

Source	Amount (US\$ million)	Percent of Total
Government financing	1,409.16	93.1
International Development Association (IDA)		
IDA Credit	100.00	6.6
Trust Funds		
Health Emergency Preparedness and Response Multi-Donor Trust Fund	3.84	0.3
Total Program Financing	1,513.00	100.00

10. **The PEF is comprised of wages and salaries; support for capacity building; goods; health insurance and social security expenses; and Program operational costs.** Almost 25 percent of the Program expenditures are estimated to be procurable. Details concerning Program expenditures are provided in Table 3. The Program is not expected to include any large-value contracts based on the inherent definition of the Program boundaries. It excludes procurement of: (1) works, estimated to cost US\$75,000,000 equivalent or more per contract; (2) goods, estimated to cost US\$50,000,000 equivalent or more per contract; (3) non-consulting services, estimated to cost US\$50,000,000 equivalent or more per contract; or (4) consulting services, estimated to cost US\$20,000,000 equivalent or more per contract.

Table 3: Description of Program Expenditures

Category	Description	Agency
Goods	Machinery, equipment, and supplies for health, information technology (IT) hardware, software, and	Participating departments/divisions of the MOHP and Provincial and Local

	office equipment	Governments (PLGs)
Non-consulting services	IT systems, upgrading and/or new management information systems for recording and reporting of health data for enhancing monitoring and evaluation.	Participating departments/divisions of the MOHP and the PLGs.
Works	Construction of bio-medical equipment, workshops, and minor repairs.	Participating Provinces.
Consultancy	For design and quality assurance of bio-medical equipment workshops, modernization of the health facilities/institutes and training of staff, and support for a unified database.	Participating departments/divisions of the MOHP and the PLGs.
Program operational expenses	Wages and salaries, health insurance subsidies, and other recurrent costs.	Participating departments/divisions of the MOHP and the PLGs.

11. **The majority of the Program expenditures will be incurred in the two provinces, Gandaki and Koshi, and their local governments for about 60 percent and at the level of the MOHP and the DOHS, that is, 24 and 14 percent, respectively.** The agency-wise Program Expenditure Framework is summarized in Table 4.

Table 4: Implementing Agencies and Shares of Program Expenditures

Agency	PforR Program ("P") - US\$ millions	Percent of Expenditure for the total Program
MoHP	363.12	24
DoHS	211.82	14
HIB	30.26	2
Provincial Governments and Local Levels therein	907.80	60
TOTAL US\$ million "p"	1,513.00	100

Source: Calculations based on Nepal Health Sector Strategic Plan (NHSSP) costing.

12. **The Program is expected to incur expenditures amounting to 37 percent for wages and salaries followed by Grants and Social Security at 27 percent.** There are budget heads linked to the expenditures. They will facilitate the easy identification and amount of Program expenditures, as summarized in Table 5. Funding predictability is reasonably high because health is a priority sector for the Government of Nepal (GON). Thus, agencies know in advance what their allocations will be, thus allowing for better planning.

Table 5: Program Expenditure by Economic Classification (mapped to budget head)

(Amount in US\$ millions)

Outcome Area	Total		Budget Lines
	Amount	Percent	
Wages and salaries	554	36.6	21111 (Remuneration – Employee), 21112 (Remuneration-Officials), 21121 (Uniform), 21122 (Food), 21131 (Local Allowance), 21132 (Dearness Allowance), 21123 (Medical Treatment)
Capacity building	36	2.4	22511 (Employee Training), 22512 (Skill Development and Awareness Training and Workshop)
Medicines and supplies	121	8.0	27213 (Medicine Purchase)
Capital goods and maintenance	55	3.6	22213 (Vehicle Repair), 31123 (Furniture and Fixtures), 31161 (Structural Improvement of Building), 31134 (Development and Purchase of Computer Software)
Grants and social security	410	27.1	26332 (Conditional Grants-Recurrent), 26336 (Conditional Grants – Capital)
Program activities	337	22.3	22522 (Program), 22529 (Misc. Program), 22611 (Monitoring and Evaluation), 22612 (Travelling), 22311 (Stationeries and Office Supplies), 22313 (Books and Related Materials), 22314 (Fuel-Other Use), 22315 (Newspaper, Printing, and Information Publication), 22411 (Service and Consulting), 22412 (Information System and Software Running), 22413 (Contract Service), 22111 (Water and Electricity), 22112 (Communications), 22211 (Fuel – Officials)
Total	1,513	100.0	

Source: Technical Assessment Report for this PforR

Note: The Conditional Grant (26332, 26336) for the two provinces and their local governments is accounted for in all

the outcome areas.

13. Budget sub-heads will be defined to the Program to ensure all items of the PEF are properly identified for reporting. The MOHP has agreed that identified budget subheads shall be reflected in the budget of FY 2023/24 by May 31, 2023, as well as in the red book of the Government for FY 2023/24.

Section 3: Review of Public Financial Management Cycle

14. Public financial management encompasses both upstream and downstream functions. Upstream functions include policy and budgeting, and downstream functions include budget execution including procurement, internal controls, accounting, reporting, and auditing. The procurement cycle, including contract management, is coherently embedded within the PFM, and it contributes to the efficacy of upstream and downstream functions. The program budget is prepared with due regard to government policy, and it is implemented in an orderly and predictable manner. The financial management of the health sector at the federal level is based on the Financial Procedures and Fiscal Responsibility Act (FPFRA) of 2019 and Regulation, 2020 under the Act. Both the provinces have passed their own Provincial Financial Procedure and Fiscal Responsibility Acts, which prescribe planning and budgeting, internal controls and internal audits, accounting and reporting, and auditing arrangements, among others. The federal MOHP and the provincial and local governments have full autonomy of financial powers to implement the Program. This is based on the Constitution of Nepal, the FPFRA (including those for the two PGs). and the Local Government Operations Act (LGOA).

3.1 Planning and Budgeting

3.1.1 Adequacy of budgets

15. The government’s health sector budget has increased each year over the five years from FY 2016/17 to 2021/22, keeping in line with the increase in the overall federal budget and Gross Domestic Product (GDP). The health sector share of the total federal budget and GDP has remained at around 10 percent and 4 percent, respectively, each year. This demonstrates the government’s priority and commitment to adequately invest in the health sector, which in turn provides reasonable assurance for budget availability in line with Nepal Health Sector Strategic Plan (NHSSP).

16. According to the MOHP’s report on “Health Sector Budget Analysis: First Five Years of Federalism” published in January 2022, since the implementation of federalism, both the volume and amount of the health budget has dramatically increased. Specifically, it has increased from Nepalese Rupee (NPR) 46.8 billion (US\$ 360 million) in FY 2017/18 to NPR 133.1 billion (US\$ 1023.85 million) in FY 2021/22. At the same time, the share of the health sector budget as a part of the national budget rose from 4.6 percent (NPR 60.4 billion [US\$ 464.62 million]) in FY 2016/17 to 8.6 percent (NPR 179.6 billion [US\$ 1381.54 million]) in FY 2020/21. This clear increase in the health sector budget can be attributed to the response to the COVID-19 pandemic. Resource allocations to the health sector from internal sources in the subnational governments (SNGs) rose from 0.5 percent in FY 2017/18 to 14 percent by FY 2021/22. This supports the fact that federalism has opened fiscal space for health. Following the implementation of federalism, the largest part of the health sector budget is allocated to the federal MOHP. The proportion of the health budget allocated in the form of conditional grants to the SNGs declined from 40 percent in FY 2018/19 to 24 percent in FY 2021/22. Similarly, the share of the administrative budget to the SNGs through conditional grants declined from 75 percent in FY 2017/18 to 26 percent in FY 2021/22.

Table 6: Health Sector Budget and Expenditures (NPR million)

Fiscal Year	Budget					Expenditures				Percent Increase from 2017/18 to 2020/21	
	2017/18	2018/19	2019/20	2020/21	2021/22	2017/18	2018/19	2019/20	2020/21	Budget	Expenditure
Health Sector	60,454.90	77,611.10	105,844.6	143,118.1	179,652.5	53,002.60	66,470.00	87,305.50	103,968.60	237%	231%
MOHP	31,781.10	34,082.30	42,670.90	60,678.80	100,974.80	27,370.30	24,485.60	30,855.80	41,516.70	191%	296%
Other Federal Ministry	9,563.70	9,564.80	10,440.70	18,209.50	13,379.70	8,583.20	12,120.60	10,028.90	8,935.00	190%	140%

Fiscal Transfer to PG	164.1	6,153.00	9,258.70	11,869.70	10,590.70	164.1	4,645.50	7,609.60	10,262.50	7233%	172%	
Fiscal Transfer to LG	18,652.90	23,330.70	29,469.60	30,830.60	29,305.00	16,778.80	21,525.60	27,713.00	28,133.20	165%	126%	
Fiscal Transfer from PG to LG			826.8	1,684.30	975.1			762.6	1,553.50			
PG Own Source		3,103.00	9,396.20	14,419.10	18,326.10		2,803.80	7,861.20	10,223.20		591%	
LG Own Source	293.1	1,377.30	3,781.60	5,426.10	6,101.10	160.2	888.9	2,474.40	3,344.30	1851%	443%	
Total		120,909.80	155,222.20	211,689.10	286,236.20	359,305.00	106,059.20	132,940.00	174,611.00	207,937.00	237%	231%

Source: Health Sector Budget Analysis: First Five Years of Federalism, MOHP (January 2022, page 9)

17. Budget are passed timely within May-end every year as per the predetermined schedule of budget preparation in Nepal well ahead of the start of the FY. Budget execution for the previous Program NHSMRP over the six years from FY 2016/17 to FY 2021/22 is 74 percent on average (Table 7).

Table 7: NHSMRP Budget and Expenditures

Fiscal Year	Amount (NPR million)		
	Budget	Expenditures	Expenditure (% over Budget)
2016/17	14,634.49	12,500.44	85.42%
2017/18	7,168.45	4,971.91	69.36%
2018/19	2,308.16	1,690.64	73.25%
2019/20	2,043.36	1,210.46	59.24%
2020/21	3,949.93	2,379.21	60.23%
2021/22	2,778.62	1,645.66	59.23%
Total	32,883.01	24,398.32	74.20%

Source: Extracted summary of PEF budget line items from the Audited Financial Statements of the NHSMRP

18. All the DLIs of the NHSMRP were successfully met through expenditures, demonstrating the effectiveness of the budget and expenditures and the efficiency of the program. No indication of any restrictions on the budget availability is observed. The impact of COVID disruption is observed in the health sector budgeting as is also depicted in Table 7, where budget is increased in FY 2020-21 and 2021-22. Indications of budget effectiveness include: an increase in the number of hospitals and health institutions, the number of patients provided with health services, better access to health services, health insurance programs, and so on. With the trend of budget and actual expenditure over the previous program period, as well as the government's priority assigned to the health sector, the FSA concludes that the government's budget will be adequate for the Program. However, the budget absorption over the last three years in the table presents only about 60%, lacking both the realistic planning and budgeting, procurement efficiency, and the absorptive capacity. Actions agreed for realistic planning and budgeting, increasing procurement efficiency, and budget monitoring are hoped to address the deficiency in budget utilization. Bank team will be following up during review missions.

3.1.2 Budget Preparation

19. Budgets are prepared at each level of government. They follow a similar process, which is standardized throughout Nepal. Budget formulation is managed jointly by the National Planning Commission and the Ministry of Finance. Central to the budget process is the Medium-Term Expenditure Framework (MTEF), which is prepared annually by the National Planning Commission (NPC). The MTEF is prepared by incorporating three years (updated each year) health sector budget estimation. It has been developed by the MOHP and the provincial health-related ministry. Based on the MTEF, an annual budget will be proposed for the total government program, that is, the Nepal Health Sector Strategic Plan (NHSSP). Efforts are underway to implement the MTEF at the LG level. However, this has yet to be institutionalized. The Provincial and Local Government Support Program (PLGSP) is providing training to the LGs to support MTEF preparation. The dedicated support units of the MOHP and DOHS will coordinate with the PLGSP to ensure health sector perspectives are adequately captured in the LGs' MTEF.

20. The proposed budget for the total government program, the NHSSP, will be consolidated by the MOHP. It will be included in the Line Ministry Budgetary Information System (LMBIS), based on administrative and economic classifications. Activities will also be segregated for each agency. The budget of each subnational government, including for hospitals and health institutions, will be budgeted as fiscal transfers (conditional grants) from the federal budget. Such budget proposals are discussed with subnational governments and hospitals. However, there is a need for extensive consultations, which in turn will support in developing activities with reasonable flexibility to allow subnational governments to meet program objectives. Currently, subnational governments are facing the challenge of spending conditional grants, including for the health sector. The difficulty involves the excessive restriction in the framing of the activities by the federal government. The federal budget book will have a separate budget sub-head for the total government program, the NHSSP. Based on the conditional grants' details provided by the Ministry of Finance, each subnational government incorporates the same into their respective budgets and obtains approval from their Assemblies.

21. The underlying basis for allocating the Health Conditional Grant (HCG) to the PGs and LGs depends upon the criteria of the MOHP. The MOHP proposes conditional grants for the PGs and LGs with budgets for each activity. The MOF decides on the conditional grant budget for the PGs and LGs. However, the prescriptive list of activities is hindering the PGs and LGs from carrying out activities according to local needs. In this regard, there is a need for greater clarity concerning the methodology used in calculating HCG allocations for the PGs and LGs. One of the most critical aspects of health financing was the delays in disbursements. To overcome the delays, the Appropriation Act of 2022 has set four disbursement tranches with fixed dates (including advances in mid-August, and reimbursements based on progress at the end of November, March, and June for each year). Advances are subject to the availability of progress reports. Subnational respondents preferred greater levels of flexibility in budget-setting, looking to align funding with local service-delivery needs. Budget-setting flexibility is best supported with effective reporting and monitoring, thereby ensuring that coordination is achieved across the entire health system.

22. The health budget is spread amongst various federal-level agencies, including the MOHP, the DOHS, and government-owned hospitals and health institutions. It also covers seven provinces, including the two provinces, as well as 753 LGs, including the LGs in the two provinces. The federal and provincial budgets are approved on time. However, according to the website³ of the Ministry of Federal Affairs and General Administration (MOFAGA), twenty-six LGs had not passed their budgets for FY 2022-23, that is, over three months from the deadline. As the delayed budget approval of the LGs will also impact the NQHSP, the dedicated support units will work in coordination with the MOFAGA to ensure timely budget approval for the LGs.

23. The MOHP has issued Health Sector Planning and Budgeting Guidelines for 2020, which applies for all levels of government (Box 1). Both the Provinces have included planning and budgeting provision in their FPFRA. The LGs under the provinces have also established planning and budgeting procedures.

Box 1: Program Planning and Budgeting

- Budget sub-head(s) identified for the Program.
- Conditional Grants to the SNGs through fiscal transfers.
- The MOHP shall coordinate in the planning and budgeting. It will ensure the timely availability of budgets to all the implementing agencies.

Source: Compiled by Assessment team

3.2 Procurement Profile of The Program

24. The Program is not expected to include any large-value contracts based on the inherent definition of its boundaries. The implementing units shall report to the World Bank if any large contracts appear throughout project implementation. In addition, the World Bank team will analyze and monitor the performance of the procurement systems, as well as the contract management reports. It will seek to identify any large-value contracts that may appear throughout the Program implementation.

³ <https://www.mofaga.gov.np/lgbudget>

25. **Procurement planning.** Annual procurement plans, including contract packaging, with applicable procurement approach, method and roadmaps are neither prepared nor published, except publication of bid notices on Nepal e-GP system. Procurement planning is clearly linked to the available budget. As such, it considers the objectives of the departments, as well as the needs of the users.

26. **Procurement profile of the program.** Based on the activities identified in the Program, the main procurable items include: (a) goods, including machinery, equipment, health supplies, IT hardware, software, and office equipment required by the participating departments and provinces; (b) non-consulting services, such as IT systems, upgrading and/or new management information system (MIS) for recording and reporting of health data, as well as for enhancing monitoring and evaluation (M&E); (c) works, including the construction of bio-medical equipment workshops; and (d) consultants to support the design and quality assurance of bio-medical equipment workshops; modernization of the health facilities/institutes; training of staff; creation of a unified database; and other Program activities.

27. **Procurement processes and procedures.** The assessment noted that the procurement framework across all the implementing agencies is similar. However, the practice of the applicable rules and regulations may slightly vary across them. All 3 implementing agencies use the Nepal e-GP system, the National Public Procurement Act (PPA), and the Public Procurement Regulations (PPR), as well as the standard procurement documents of the Public Procurement Monitoring Office (PPMO). Procurement processes and procedures show that the procurement system ensures a fair and transparent procurement process. However, a substantial improvement in the procurement practices is required, for example, the preparation of an annual procurement plan in the beginning of fiscal year, or the publication of contract awards information, including quoted prices of the participating award-winning bidders.

28. **Procurement regulatory framework.** The legal and regulatory framework guiding public procurement in Nepal is comprehensive and well defined. The challenges and risks associated with public procurement include the practices involved in its planning and execution, including limited capacity in following procurement regulations and guidelines, at the local government level. The current Public Procurement Act (PPA) was enacted on January 14, 2007, and the Public Procurement Regulations were enforced in August of the same year. The regulatory function covers the entire process of procurement, including the preparation of procurement plans and cost estimates; provisions related to procurement and the selection of contracts; qualification criteria; technical capacity/specification; provisions relating to tenders/consultancy services; various forms of procurement, including thresholds and procedures for application of different methods of procurement (from open bidding to single sourcing); the renting of house and land; contract implementation; dispute settlement and monitoring, and so on. The PPA was amended in July 2016, and 12 amendments have been made to the PPR. Some of the amended provisions like none of the firms' five contracts with overlapping implementation period are not in line with good public procurement practices that will affect competition and overall procurement environment in the country as well as for the program.

3.3 Treasury Management and Funds Flow

29. Based on approved federal budget, the federal agencies make payments to their payees (for federal program expenditures) from the federal treasury single account. This is done by issuing payment orders through the computerized Government Accounting System. Based on the same budget, the DTCOs make fund transfers of conditional grants to each of the subnational governments in line with the Financial Procedures Act. These are implemented in four installments. These fund transfers are sent to the consolidated fund of each of the subnational governments, that is the provincial and local governments.

Box 2: Treasury, Fund Flow and Disbursements

- Expenditures at federal level are paid through the federal treasury through the respective DTCOs of the implementing agencies.
- SNG expenditures incurred from the conditional grants are transferred by Federal Government into the SNG consolidated fund.
- The MOHP requests fund disbursements through verified DLIs.
- Program expenditures are reconciled every year and at the end of the Program to ensure that the bank's contribution does not exceed Program expenditures.

From these consolidated funds, each subnational government makes payments to their payees (for their respective program expenditures).

Source: Compiled by Assessment team

30. **Disbursement arrangements.** Disbursements will be made based on the achievement of results under each DLI. The GON will prefinance expenditures for the Program using its own budgetary resources through the identified budget lines of the Program Expenditure Framework (PEF). The MOHP will prepare technical reports to document the achievement of the DLIs, which will then be verified by the designated independent verification agent (IVA). MOHP will submit the evidence of prior results to the Bank for review. Upon verification of the prior results by the Bank and DLI target by the IVA, the MOHP will communicate their achievement with and corresponding allocations to the World Bank, along with the supporting documents, requesting disbursement. The World Bank will review the evidence submitted by the government to inform of its acceptance of the achievement of the DLIs. The World Bank will communicate to the implementing agency its endorsement of the achievement of the DLI results and then confirm the allocation for disbursement. The MOHP will then submit a withdrawal application of the said amount with supporting documents to the World Bank for disbursement into the Government's Treasury Account. The DLIs for this Program are not timebound. Hence, if the DLI targets are not achieved in the anticipated year, disbursement may be rolled over to the future years until such time as the DLI target is achieved (within the Program closing date). For non-scalable DLIs, the World Bank will disburse the DLI value only upon full achievement of the DLI result. For scalable DLIs, the World Bank will disburse the DLI allocation in proportion to its verified achievement and targets, as set out in the DLI matrix.

31. **Reconciliation.** Within six months of the closing date, a reconciliation of expenditures financed under the Program and disbursements made by the Bank will be conducted by the MOHP and reviewed by the Bank. There are 3 financing sources, including the IDA Credit, the IDA Shorter Maturity Loan, and the Health Emergency Preparedness Multi-Donor Trust Fund. To facilitate this reconciliation, the expenditures with budget codes that can be financed under the Program will be considered from the audited statements. Cumulative Program expenditures and the cumulative disbursements will be reconciled every year during the implementation to monitor the execution of PEF. Other sources of financing will not be included in this comparison. The aggregate disbursements under the Program should not exceed the total Program expenditures by the Government, considering other sources of financing, if any. If Bank financing under the three financing sources exceeds the total amount of Program expenditures, the Government is required to refund the difference to the Bank.

3.4 Accounting and Financial Reporting

32. Accounting and financial reporting procedures for all government entities, including those in the health sector, are prescribed by the Financial Procedures and Fiscal Responsibility Act of 2019 and the Regulation under the Act (FPFRA/R). Accounting is maintained through the Computerized Government Accounting System (CGAS) by the MOHP, the DOHS, and all federal implementing agencies individually (for their NQHSP budget execution). Similarly, the Provincial Health Ministry maintains accounts in the Provincial CGAS for their NQHSP budget execution. All the LGs maintain accounts for their NQHSP budget execution in the Subnational Treasury Regulatory Application (SuTRA). However, as the SuTRA is an online platform, many local governments, especially rural municipalities, cannot update accounts daily given challenges with access to Internet and electricity. To facilitate this, the DTCOs have been supporting those LGs to update their accounts periodically, for example, once in two weeks. This is done by coming to the concerned DTCO Office. The information from the CGAS, the provincial CGAS and the SuTRA is available in real time to the FCGO. The MOHP has been obtaining such information from the FCGO for preparing consolidated interim and annual financial reports for the Program. This mechanism has strengthened the timely reporting of the three tiers of government. The timeliness is expected to further improve in the NQHSP, as the government is expanding fiber optics throughout Nepal. To monitor the financial progress in PEF, MOHP shall submit quarterly in-year interim unaudited financial reports in a template agreed by the Bank team within sixty days of the period-end.

33. The Program Operating Guidelines (POG) used for the previous Program, the NHSMRP, shall be

updated for the NQHSP, as required for accounting and reporting purposes. The consolidated annual financial statements of the three tiers of government are publicly available on the FCGO's website⁴, which includes the budget execution status of the health sector. At the provincial and LG budget entities, there are challenges in not complying with the timely reconciliation of accounts, as prescribed by the financial regulations⁵. Provincial governments are also keeping records of their financial assets, but information about their performance is not published. The OAG reports noted that the provincial governments have not prepared consolidated statements of assets. Also, information concerning the transfer and disposal of financial and non-financial assets is not included in budget documents or financial reports. The same observation has been made at the LG levels, as reflected in the OAG audit reports of the LGs.⁶

34. Reconciliation between the fiscal transfers provided by the federal government to the subnational governments and the spending of such fiscal transfers (conditional grants) only happens toward the end of the fiscal year. Program support units will coordinate with the implementing agencies at the federal, provincial, and local levels to carry out regular reconciliations. The Public Asset Management System (PAMS), supported by the World Bank, has been implemented in the three tiers of the government. The NQHSP training will ensure that the program assets are timely, and that they are accurately recorded in the PAMS in the three tiers of government.

35. For FY2019/20, the OAG reported that as many as 360 of the 753 LGs had not maintained bank reconciliation statements, with 345 LGs having significant unreconciled balances.⁷ The LGs that are not reconciling bank accounts have been significantly reduced to 82⁸ in FY 2020-21. This has become possible by enhancing bank reconciliation feature in SuTRA. Integrated Public Financial Management Reform Project – P164783 (IPFMRP) and the Provincial and Local Government Support Program (PLGSP)⁹ are supporting LG's financial management systems by providing support in preparing model regulations, guidelines, enhancing SuTRA, and providing trainings to the staffs

Box 3: Program Accounting and Reporting

- The CGAS, the Provincial CGAS, and the SuTRA are used for accounting purposes.
- The MOHP consolidates all financial reports for the Program.
- Six-monthly Interim Unaudited Financial Reports (IUFs) will be submitted to the Bank within 60 days of the period end.
- Program financial statements shall be prepared separately from the whole government program.
- The OAG conducts audits for the program and it issues a single audit report, along with the audited program financial statements.

Source: Compiled by Assessment team

3.5 Procurement Processes and Procedures

36. **Procurement systems analysis.** The recent achievements of Nepal in its procurement reform efforts include the introduction of e-Government Procurement (e-GP) managed by the PPMO; and an electronic bidding system for publicly financed contracts that enhances and strengthens security, fair competition, transparency, accountability, and efficiency in the procurement processes. However, the actual application of the system by the procuring entities is not reported on by the PPMO. Indeed, neither the number of entities nor the share in terms of the number and value of contracts awarded through the e-GP have been reported. Further, the use of the full features of the e-GP, that is, the contract management module available in the e-GP, has not been made mandatory for public entities. Currently, the e-GP is being used for bidding, including online bid submissions and the public opening of bids. Public procurement is particularly susceptible to corruption in Nepal, and non-compliance with procurement regulations is one of the frequent qualifications reported on by the OAG. Although the

⁴ <https://fcgo.gov.np/reporttype/1>

⁵ Among others, the OAG's audit report for FY2020 states that the arrears of the government offices are at 9.1 percent of total expenditures, with as much as 15.5 percent for LGs.

⁶ <https://oag.gov.np/local-level/report/en>.

⁷ See also the Fiduciary Risk Assessment by the Royal Norwegian Embassy in Kathmandu from December 2021.

⁸ OAG Summary Report for FY 2020-21 Page 39

⁹ <https://plgsp.gov.np/>

procedures for bid processing and awards are followed, there are some cases of collusion among bidders, especially concerning works procurement. There are also deviations between tendered and delivered supplies. The lengthy process of contract approval and disposal of audit observations has also adversely affected project implementation. Offices at the implementation level lack resources and capacity. They require expert services to assist them in planning and implementing the proposed project.

37. **Procurement management by agency.** Although procurement capacity varies across ministries, insufficient skills, and incentives to effectively manage the procurement process remain a constraint. Frequent staff rotation within line ministries makes it difficult to sustain and accumulate knowledge, as well as build institutional memory. Similar challenges exist at the subnational level. It was noted in a capacity needs assessment¹⁰, that half of all provinces acknowledged having limited procurement capacity.
38. The broad outline of the Program Expenditure (‘Big P’) related to procurement is provided in Table 8, along with the corresponding IDA funding.

Table 8: Procurement Expenditure Profile (US\$ millions)

Procurement Break down	Implementing Agencies			
	MoHP	Koshi	Gandaki	Total
Total Allocation				1,513
Consultancy	√	√	√	
Goods				
Non-Consulting Services (IT systems)	√	√	√	
Works		√	√	
Total				
IDA				100
Trust Fund	4			4

Source: DOHS

Note: IDA 100 million, Trust Fund 4 million, GON 1,409 million. The following should also be noted: (i) the value of procurement done by the DOHS is quite small; (ii) the value of procurement done by other central level agencies (CLAs) is even smaller. As such, it is not presented here; and (iii) There is almost no procurement of works at the central level.

39. **Procurement processes and procedures (PPRs).** The PPRs are prescribed procedures for complaints related to procurement. They have two levels: the administrative level and the independent process. The administrative process involves the handling of complaints by the implementing agency. When the complainant is not satisfied with the outcome of the administrative process, it may be followed by an independent process.

40. **Open tendering.** This is used with whatever systems are available. In line with the PPA and the PPR, it is mandatory to use the open tendering method as the preferred method for procurement of goods, works, and non-consulting services. In the case of procuring consultancy services, the use of quality- and cost-based selection is the preferred method. According to the PPR, advertisements for prequalification, bids, and expressions of interest shall always use the prescribed standard formats. Also, each advertisement should be published in at least one daily newspaper with a wide circulation in Nepal. It is also mandatory for all procuring entities to publish advertisements on their website, as well as on the PPMO website.

¹⁰ World Bank. “Nepal. Capacity Needs Assessment for the Transition to Federalism.” (World Bank, July 10, 2019).

3.6 Contract Administration

41. The delayed release of budget allocations is another challenge to the implementation of procurement. Budget execution is low early in the fiscal year and picks up as the year progresses. As a result, projects can only be implemented when a corresponding revenue inflow occurs, which pushes spending toward the end of the fiscal year.

3.7 Internal Controls

42. The MOHP has developed internal control guidelines for the Ministry and its offices. As the audit reports have not reported non-compliance of the guidelines themselves, they are expected to comply. The World Bank also supported the MOFAGA in developing internal control guidelines for local governments. Based on those guidelines, the MOFAGA is providing them with training, which is expected to institutionalize the required control mechanisms in the LGs in the future. However, sector-specific requirements, such as those of the health sector, are not included in those guidelines. The POG of the predecessor program, the NHSMRP, incorporates such health sector-specific additional control requirements for the federal, provincial, and local governments. The POG will be updated with additional requirements of the NQHSP by August of every year, and the agencies concerned will be trained to ensure compliance. The financial procedure laws of the federal, provincial, and local governments have stipulated various internal control measures regarding planning and budgeting, fund flow, accounting, and reporting.

3.8 Internal Audit

43. According to the FPFRA of 2019, considerable progress has been made regarding internal audit through the development of a separate pool of federal internal auditors; and internal audit guidelines (Box 4). This initiative is supported by the World Bank through IPFMRP. The same internal audit guidelines are applicable to the health sector and the NQHSP in terms of the federal government's expenditures. The internal audit of the MOHP, the DOHS, and other federal level implementing agencies is done by the federal internal auditors. Similar provisions are incorporated in the provincial laws, and provincial governments are developing separate internal audit units accordingly. Meanwhile, the Provincial Treasury Comptroller Offices are currently conducting an internal audit of provincial government expenditures, including the health sector. The details of the required internal audit of the NQHSP will be included in the updated POG. There are still many LGs that have not yet established internal audit functions. The OAG report for FY 2020-21 mentioned that 250 LGs did not carry out an internal audit. Since the Program shall be implemented in the two provinces – Gandaki and Koshi, the Bank team assesses that the internal audit can be regularized by the support and monitoring from the Program Support Unit at the MOHP.

Box 4: Internal Control and Audit

- The Program Operating Guidelines (POG) will be prepared and updated every year as required.
- The internal control guidelines will be updated and implemented.
- The internal audit will be carried out regularly and suggestions will be pursued.

Source: Compiled by Assessment team

A lack of quality is also observed in the LG's internal audit reports. The LGOA and the financial procedure laws of the provincial and local governments have stipulated that regular internal audit be conducted. Governments are also required to follow up on the suggestions from internal audit. The Program's support units will be maintaining timely and quality internal audits.

3.9 Program Governance and Anti-Corruption Arrangements

44. **The legal and institutional framework for anti-corruption exists.** Nepal signed and ratified the United Nations Convention against Corruption in 2003 and 2011. Fraud and corruption-related offenses are sanctionable under the Prevention of Corruption Act of 2002, the Commission for Investigation of Abuse of Authority Act (CIAA) of 1991, and the Anti-Money Laundering Act of 2008. The CIAA is an independent authority, founded in 1991 by virtue of the CIAA Act of 1991 and the provisions under the Constitution of Nepal of 1990. The CIAA has the legal mandate to investigate and prosecute corruption cases. Apart from the CIAA, the OAG and the Attorney General also have the mandate to address issues related to corruption.

45. **Despite the efforts, corruption remains prevalent in Nepal, including in the health sector.** The Corruption Perception Index, 2021 ranks Nepal at 117 out of 180 countries. This represents a marginal improvement from a ranking of 122 among 179 countries in 2017. The World Governance Indicator, 2021 percentile ranking on corruption remains low, although there has been a gradual improvement from 23.2 in 2011 to 29.8 in 2020. Moreover, the Global Corruption Barometer of 2020 indicates that 84 percent of the respondents identified corruption as a problem, and 12 percent reported paying a bribe for public services. According to the CIAA, the health sector is one of the five most vulnerable sectors to corruption (Table 9). There are also issues related to the timeliness and quality of audit reports prepared by the Ministry of Health and Population. Furthermore, the annual audit report of the OAG for FY21 outlines major audit issues in the health sector. These are related to the inadequate supply of essential medicine, equipment, and doctors. There is also limited availability of consolidated financial statements of the hospitals.

Table 9: CIAA Cases in the Health Sector, FY2017 – FY2022

Fiscal Year	Cases		
	Total	Health Sector	Percentage of Cases related to the Health Sector
2017-18	11,769	626	5.32%
2018-19	16,997	714	4.20%
2019-20	8,558	248	2.90%
2020-21	14,425	616	4.27%
2021-22	8,093	231	2.85%

Source: CIAA Reports, multiple years.

46. **The Government of Nepal identifies anti-corruption as a core priority.** The GON has introduced the Sub-national Treasury Regulatory Application to track expenditures to the local governments. The Appropriation Bill of 2022 mandates the financial and physical verification of public investments. However, such measures need to be fully implemented.

47. **Conclusion and Mitigation Measures - The Assessment concludes that the fraud and corruption risks are Substantial.** Potential risks are associated with the nature and size of the Program expenditure framework, as well as with the vulnerabilities associated with the complexities of federalism. Although the OAG’s audit reports have not found any corruption issues related to salary expenditures, the World Bank’s Integrity Vice-Presidency (INT) review and the OAG’s audit reports found procurement and the supply of medicine and equipment to be susceptible to corruption. Corruption cases in the health sector are mainly related to civil works, contracts to procure equipment, and other large procurement packages. Most common forms of corruption reported relate to contractors compromising the quality of construction, and collusion among bidders to rotate bids. Other issues that have been reported include challenges in preparing quality bidding documents, terms of reference (TOR), request for proposals, ensuring appropriate evaluation based on pre-established criteria, and approval of contracts. Additionally, the Anti-corruption Assessment of the parent Program found that corruption risks were high. However, it also found that the MOHP did not have adequate institutional mechanisms to tackle them, especially in the context of PforRs. Although the MOHP does not have a designated team or codes of conduct to manage corruption issues, the Program will design measures to help mitigate the risk of corruption.

48. **The PforR will help establish mitigation measures under the Program.** The Bank proposes to:

(i) implement the Program in accordance with the Anti-Corruption Guidelines (ACG) of the World Bank; (ii) establish a functional grievance redressal mechanism to address corruption risks associated with the Program; (iii) conduct annual social audits and utilize the findings to strengthen accountability measures in the Program; and (iv) designate a focal person within the Project Implementation Unit (PIU) or the MOHP to coordinate on governance and accountability issues.

49. **The World Bank’s Guidelines on Preventing and Combating Fraud and Corruption in Program for Results Financing will apply to the entire Program.** If required, the Bank should have access to any information related to contracts under this Program (even if held by third parties/contractors). In addition, the Bank should have the right to investigate any allegations of fraud and corruption within the Program.

50. **The Program would need to be implemented in accordance with the World Bank’s Anti-Corruption Guideline (ACGs) for PforR operations dated February 1, 2012, and revised on July 10, 2015.** Requirements under these guidelines include, but are not limited to:

- i. **Sharing of information concerning fraud and corruption allegations:** The MOHP will share with the World Bank any information concerning allegations of corruption received from both the public and its own investigation every year.
- ii. **Use of World Bank debarment list of firms and individuals for the Program:** The MOHP will share with the procuring entities a list of firms or individuals on the World Bank’s debarment or suspended list,¹¹ and it will ensure that these are not allowed to bid for contracts or benefit from a contract under the operation during the period of debarment or suspension. Additionally, the agencies will ensure that the contract documents include a clause that the vendors will follow the Bank’s ACGs. Measures would also need to include maintaining a grievance redressal system. The MOHP will check compliance and report to the World Bank every year as part of the reporting requirements of the operation.

51. **Investigation of Fraud and Corruption Allegations:** The World Bank’s Institutional Integrity Vice Presidency (INT) retains the right to conduct administrative inquiries on corruption allegations made against the Program. In all such cases, the MOHP and CIAA will collaborate with the INT to acquire all records and documentation that the INT may reasonably request from the operation regarding the use of the Program financing. All allegations of fraud and corruption will be investigated by the CIAA.

3.10 Program Auditing

52. Article 241 of the Constitution of Nepal has mandated the Office of the Auditor General (OAG) to carry out external audits of all government offices and sub-national governments, including the health sector. The OAG conducts these audits in accordance with the International Standards of Supreme Audit Institutions (ISSAI), as pronounced by the International Organization of Supreme Audit Institutions (INTOSAI). This includes financial, performance and compliance audits.

53. The OAG conducts a mandatory final audit of all MOHP cost centers every year. Performance audits are also conducted in accordance with the annual audit plan of the OAG. In FY 2018/19, two topics out of a total of eleven performance audits conducted by the OAG were related to the MOHP, that is, the regulation of health services, and the quality of patient care. Also, in FY2017/18, the performance audit was carried out concerning drug administration. These performance audits are made available to the Bank and reported in the OAG’s annual report. The 58th Annual report of the OAG for FY 2019/20 found that the procurement of medical items conducted at the MOHP was against the country system. It was done without proper due diligence concerning the technical aspects (that is, procurement-related issues).

¹¹ The World Bank. Procurement-World Bank Listing of Ineligible Firms and Individuals. <https://www.worldbank.org/en/projects-operations/procurement/debarred-firms>

54. The OAG’s annual audit reports for FY 2018/19 to 2020-21 show the following information about audits under the MOHP from FY2018-21 (Table 10).

Table 10: MOHP Audit Amounts and Audit Observations (NPR billions)

Fiscal Year	Audit Amount	Audit Observations				% of Audit Observations on Total Audit Amount
		To be Recovered	Evidence Required	Advance Unsettled	Total	
2020-21	36.46	0.17	0.45	0.60	1.22	3.35%
2019-20	23.96	0.01	0.81	1.02	1.84	7.68%
2018-19	19.63	0.03	0.34	0.95	1.32	6.72%

Source: OAGN Audit reports, multiple years

Table 10 shows that the audit amounts have increased, whereas the percentage of audit issues decreased in the last FY 2020-21. However, there are significant amounts of unsettled advance amounts (internal control issues). The major audit issues reported in the health sector, as included in the latest OAG annual audit report for FY 2020-21, includes issues, such as duplication of program activities e.g., the GON provided facilities to the citizens from different government agencies, indicating a need for a suitable strategy that should be taken by the Health Insurance Board (planning and budgeting issues). The audit management letter also reports that previous years’ audit issues are settled partially only (audit follow up issues).

55. The Bank team has suggested that the MOHP develop as a priority an Audit Arrears Resolving Action Plan (AARAP) with timelines and assigned responsibilities. The AARAP should also have clear results indicators to be monitored on a regular basis by the MOHP. This will facilitate the timely resolution of issues supported, including robust documentation and justification from the responding entities. The Bank team has assured support to the MOHP in developing and implementing the AARAP. The MOHP and other implementing agencies maintain records of the audit queries. The audit report has been published on the OAG website¹², and it is easily accessible to the public. The audit reports of each entity audited have been distributed to all responsible authorities under the MOHP. In addition, since 2012, the MOHP formed an Audit Committee with high-level MOHP officers. However, the committee’s proactiveness in resolving the audit issues is not observed as tangible as expected. The Secretary of the MOHP chairs the committee. According to its terms of reference, the committee’s role includes the strengthening of the internal control system; ensuring financial discipline; organizing regular meetings; and responding to audit queries. This committee has taken the lead in preparing and finalizing the MOHP’s audit clearance and internal control guidelines. The committee also instructs all concerned cost centers to take appropriate action to resolve audit observations, as well as to commit to building the capacity of finance officers to resolve audit issues. But the audit committee is not actively functional on the assigned responsibilities and MOHP has committed to make the committee more functional by setting a clear provision in the updated POG.

56. The OAG report for the MOHP is issued with significant delays due to several complexities related to audit programming, the dispersion of cost centers, as well as the late submission of accounts and supporting documents (accounting and reporting issues) by the MOHP and its units. The Bank is reinforcing its dialogue with the OAG and the MOHP to improve the situation. The World Bank has discussed with the leadership at the OAG the importance of timely audit and issuance of audit reports. For its part, the OAG has provided their assurance about maintaining the timeliness of audit reports (Program auditing issues). A joint World Bank-Asian Development Bank-OAG task team has been formed to improve on audit timeliness and enhance the quality of the audit reports. A workshop was conducted to support the issuance of timely and effective audits. There are no overdue audit reports to be received by the Bank from the implementing agencies concerned. The NHSMRP’s audit reports for the three FYs from 2018/19 to 2020-21 were received about two months overdue for each year. As the OAG is the auditor for the entire NQHSP Program and for all tiers of the government, including the HIB, the program audit report will be available from the OAG (Box 5).

¹² <https://oag.gov.np/menu-category/926/ne>

Box 5: Program Audit

- The OAG will be the auditor for all the implementing agencies.
- A consolidated audit report shall be submitted to the Bank by the OAG nine months from the end of the fiscal year.
- Audit observations will be recorded and followed up on a regular basis.

Source: Compiled by Assessment team

3.11 Procurement and Financial Management Capacity

57. As noted, financial management staff at the MOHP are stretched with their routine jobs. Therefore, a dedicated Program FM Consultant at the MOHP may be needed to assist with these issues. Regarding procurement staffing, although the program procurement is of small value, it is recommended that a full-time procurement specialist be hired for the management and monitoring of procurement activities, including support to provincial ministries, as well as the application of Anti-Corruption Guidelines under the Program. It is also recommended that one procurement specialist be hired in the ministry of each of the participating provinces, Gandaki and Koshi.

3.12 Transparency and the Publishing of Financial Statements

58. The financial reports from all tiers of the government are compiled and consolidated by the FCGO at the federal level. The consolidated financial reports are also published on the FCGO website¹³, making them available to the public. The OAG's Annual Audit Report is also published, and it includes observations about the health sector and development partner-supported health programs.

Section 4: Program Systems and Capacity Improvements

59. The overall fiduciary risk of the envisaged PforR operation is rated as Substantial, given the proper implementation of the proposed mitigation measures (Table 11).

¹³ <https://fcgo.gov.np/reporttype/1>

Table 11: Risk and Proposed Mitigation

S. No.	Risks	Mitigation Description	Timing	Responsibility	Completion Measurement	Type of Action (DLI, FIG, PAP, Legal covenant)
1.	Planning and Budgeting					
1.1	Planning and budgeting coordination is lacking among the implementing agencies.	Timely coordination in preparing the Annual Work Plan and Budget (AWPB) among the implementing agencies that cover the Program.	FY 2023/24 and continual	MOHP	AWPB prepared along with feedback from Bank team and Program activities carried out with adequate budget.	Financial Management Action Plan (FMAP)
1.2	Risk of Program reporting in lack of identified Program Budget Sub-heads.	Coordinate with the Ministry of Finance (MOF) for identifying Program Budget Sub-head(s).	2023 May 31	MOHP	Budget Sub-heads are identified and maintained in the red book.	FMAP
2.	Procurement					
2.1	As the main implementing agency for IPF component and main coordinating agency of the Program, the DOHS is mainly staffed with health and administration professionals who do not have adequate knowledge and experience to manage procurement.	The DOHS to hire a procurement consultant for providing procurement support and training to the LGs in addition to onboarding dedicated procurement experts in each of the two participating provinces.	2023 December	MOHP/ DOHS	A procurement consultant is in place in the DOHS. Procurement expert in each of the Koshi and Gandaki provinces.	FMAP
2.2	Procurement entities have limited technical and procurement capacity.	Provide training for procurement management and e-GP implementation to at least two officials of the participating sub-national governments.	2024 April	MOHP/ DOHS/ PPMO	Implementing agencies using the e-GP for entire pre-award phase including procurement plan applicable to all procurement above NPR 6 million.	PAP
2.3	Transparency of contract awards.	All contract awards in FY24 under the program will be published on the MOHP website, as well as in the respective government websites of all implementing entities	2024 July	MOHP	Awarded contracts published	FMAP

S. No.	Risks	Mitigation Description	Timing	Responsibility	Completion Measurement	Type of Action (DLI, FIG, PAP, Legal covenant)
3.	Internal Control and Internal Audit					
3.1	Non-compliance with the applicable internal control and audit requirements at the federal and sub-national levels.	This would include: (i) Implementation of internal control guidelines; (ii) internal audit carried out regularly and quality enhanced; and (iii) strengthening the accounts committees at the local level with monitoring from MOHP and the DOHS.	2023 July and continual	MOFAGA	This would include compliance with internal control guidelines; (ii) regular internal audit reports prepared according to quality standards; and (iii) the Accounts Committee actively functioning.	PAP
3.2	Inadequate FM staff capacity	Hiring of FM consultant	2023 July	MOHP	FM Consultant on board at the MOHP/DOHS, as required.	FMAP
4.	External Oversight and Audit					
4.1	The audit for the previous program, the Nepal Health Sector Reform Program (NHSMRP), is delayed, indicating risk for the program audit.	The MOHP coordinates with Office of the Auditor General (OAG) to issue timely audits.	2023 July and continual	MOHP/ MOFAGA	Program audit reports submitted on a timely basis.	FMAP
4.2	Follow-up on audit observations is weak at all levels.	The follow-up on audit observations is ensured through the Accounts Committee at all levels of government, which in turn will be monitored by dedicated support units from the MOHP and the DOHS. Program audit observations shall be followed up with Audit Arrears Resolving Action Plan (AARAP).	Annually	MOHP	Records of audit observations updated. AARAP expediting resolving audit issues	FMAP

S. No.	Risks	Mitigation Description	Timing	Responsibility	Completion Measurement	Type of Action (DLI, FIG, PAP, Legal covenant)
5.	Fraud and corruption risks	This includes (i) assigning a Coordinator for Governance (PMU/MOHP) and anti-corruption issues; (ii) establishing a functional Grievance Redress Mechanism; and (iii) conducting an annual social audit.	Annually	MOHP	Grievance redress system established and functional (online).	FMAP

Section 5: Program Implementation Support

60. The World Bank team will conduct regular missions to support the implementing agencies in monitoring implementation progress and addressing underperforming areas. Fiduciary support includes orientation for the FM and procurement staff of the implementing agencies at the initial stage of the program implementation, and, as and when required, thereafter. The DOHS will work in coordination with the Bank procurement team to provide procurement orientation for the provincial and local government staff involved in managing procurement. This will involve a considerable size of procurement of works (about NPR 50 to 60 million [US\$ 0.5 million]). The program's fiduciary support will include: (i) helping the borrower resolve implementation issues and carry out institutional capacity building; (ii) the monitoring of the performance of fiduciary systems and audit reports; (iii) reviewing key documents generated by the implementing agencies, such as Terms of Reference, procurement progress, contract management, and procurement complaints; (iv) adherence to Anti-Corruption Guidelines, and so on; (v) providing suggestions for improvement; and (vi) monitoring the changes in fiduciary risks to the Program and, as relevant, compliance with the fiduciary provisions of the legal covenants.

61. The mission will review the PAP and FMAP during every mission and agree on an action plan based on the work done by the project team. Continuous support will be given to the client for implementing the PAP and FMAP. The team will review implementation progress reports on a timely basis and monitor the findings of the PPR and audit reports on a regular basis. The PMU will regularly share key performance indicator (KPI) reports with the World Bank task team to monitor the fiduciary (FM, procurement, and governance) performance, identify gaps, and recommend actions. These reports will be reviewed, and any issues identified will be addressed appropriately.

62. The team will monitor the fiduciary performance indicators (Table 12).

Table 12: Fiduciary Performance Indicators

Indicator	Measure	Timeline
Adequate monitoring of the procurement activities	Percentage of contracts awarded and completed within the original contract period.	Annually
	Average number of quotations/bids received.	
	Percentage of contracts by value requiring amendment towards Extension of Time (EOT) of more than 30 days.	
	Percentage of contracts by value requiring amendment to account for cost escalation (in percentage terms).	
	Number of procurement-related complaints received and upheld.	
	No contract exceeds the threshold for high-value contracts.	
Adequate monitoring of FM activities pertaining to the program	Adequate AWPB to meet program activities.	Every year at the time of budget declaration
	Compliance with internal control guidelines increased with budget, accounting, and internal and external audit reports.	Every year
	Audits completed on a timely basis, and reports submitted to the Bank on a timely basis.	Annually
	Audit observations settled in a timely manner.	Annually

**Annex 1: Budgeted and Actual Program Expenditures for FYs 2016/17 to 2021/22
NHSMRP (P160207) (NPR million)**

Particulars	2016/17		2017/18		2018/19		2019/20		2020/21		2021/22		Total	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual (Unaudited)	Budget	Actual
US\$/NPR Exchange Rate of Year End	103.46	103.46	109.94	109.94	110.2	110.2	120.97	120.97	119.64	119.64	127.51	127.51		
Consumption Expenses	7,804.73	7,542.30	1,626.75	1,283.52	622.97	554.62	402.15	400.39	688.86	601.36	836.70	738.43	11,982.16	11,120.62
21111 Employee Salaries	6,267.80	6,123.83	1,383.16	1,157.91	566.24	503.06	378.04	379.65	675.11	589.30	820.96	726.49	10,091.30	9,480.24
21112 Official Salaries	428.35	380.27	72.90	28.46	9.43	7.43	7.22	7.22	6.60	5.86	6.60	4.83	531.10	434.08
21113	252.37	223.39	50.44	31.27	25.14	23.79							327.95	278.46
21114	101.33	90.63	18.00	3.46	-	-							119.33	94.09
21119	143.56	138.52	70.14	39.34	14.67	14.20							228.37	192.07
21121 Uniforms	554.44	536.06	32.11	23.08	7.50	6.13	7.78	5.97	7.05	6.16	8.95	7.04	617.83	584.44
21122 Meals	56.88	49.59			-	-	9.10	7.54	0.10	0.04	0.20	0.07	66.28	57.24
Office Operations and Service Expenses	1,591.02	1,306.87	1,319.37	968.08	410.18	338.84	434.92	335.81	804.77	239.07	323.34	209.99	4,883.60	3,398.65
22111 Water and Electricity	65.13	59.21	62.22	52.70	34.10	29.32	39.89	37.16	40.26	29.56	61.70	48.77	303.29	256.72
22112 Communications	36.50	29.42	44.89	24.64	10.23	7.28	11.10	7.90	13.36	10.38	17.90	10.63	133.99	90.25
22121	26.53	20.40	10.06	6.96	1.65	1.65							38.23	29.01
22122	1.85	1.84	1.85	1.71	1.90	1.88							5.59	5.44
22211 Fuel Official	35.38	33.10	29.55	27.48	25.58	25.49	2.30	1.72	2.03	1.94	2.00	2.00	96.84	91.72
22212 Fuel for Office Purposes	44.39	44.11	39.12	35.84	23.29	22.69	26.37	22.83	27.59	24.89	36.08	30.41	196.85	180.77
22213 Maintenance – Vehicles	5.86	0.79	6.81	1.88	4.11	3.54	22.38	20.90	37.38	35.47	49.14	38.79	125.67	101.37
22311 General Office Expenses	184.26	151.83	112.20	111.19	76.04	74.30	103.25	85.12	36.50	33.95	38.35	37.15	550.60	493.54
22312 Feed for Animals and Birds	0.08	0.08	0.09	0.09	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.20	0.67	0.67
22314 Fuel for Other Purposes	1.60	1.25	291.00	235.00	0.40	0.34	2.50	1.48	1.67	0.67	4.00	2.73	301.17	241.47

Particulars		2016/17		2017/18		2018/19		2019/20		2020/21		2021/22		Total	
		Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual (Unaudited)	Budget	Actual
22411	Consultant and Service Fees	440.80	310.68	544.49	337.62	129.10	102.17	154.30	90.42	125.53	85.45	98.90	25.49	1,493.12	951.83
22412	Information System and Software Operation Expenses	738.43	644.28	169.36	125.49	73.71	51.33	4.10	2.95	9.60	8.23	5.37	4.63	1,000.58	836.91
22711	Misc. Expenses	10.21	9.87	7.73	7.50	29.97	18.74	68.63	65.23	510.75	8.43	9.70	9.19	636.99	118.96
Service and Production Expenses		5,238.75	3,651.27	4,222.33	2,720.31	1,275.02	797.19	1,206.29	474.27	2,456.30	1,538.78	1,618.58	697.24	16,017.26	9,879.05
22313	Books and Materials	1.60	1.25	1.10	1.02	0.50	0.27	0.50	0.24	0.50	0.21	0.10	0.10	4.30	3.09
22511	Employee Training	127.04	107.93	131.05	113.90	45.80	38.08	81.60	32.34	74.40	35.53	51.35	37.10	511.25	364.87
22512	Skill Development and Awareness	711.64	435.56	590.18	420.15	121.10	89.06	53.60	15.83	43.20	6.27	19.95	9.92	1,539.67	976.79
22522	Program Expenses	4,206.46	2,938.34	3,328.84	2,032.64	1,039.75	626.67	999.29	389.90	2,277.40	1,464.41	1,479.98	615.87	13,331.71	8,067.82
22529	Other Program Expenses	1.49	1.23	2.28	1.89	0.30	0.30	5.00	2.82	1.50	1.24			10.57	7.48
22611	Monitoring and Evaluation	176.51	153.82	160.32	143.04	57.85	38.38	59.61	31.64	55.25	30.71	58.80	28.97	568.34	426.56
22612	Travelling Expenses	14.01	13.13	8.56	7.69	9.72	4.43	6.69	1.50	4.05	0.41	8.40	5.29	51.43	32.45
Grand Total		14,634.49	12,500.44	7,168.45	4,971.91	2,308.16	1,690.64	2,043.36	1,210.46	3,949.93	2,379.21	2,778.62	1,645.66	32,883.01	24,398.32
Proportion of budget executed			85.42		69.36		73.25		59.24		60.23		59.23		74.20