

FIDUCIARY SYSTEMS ASSESSMENT – ADDENDUM

I. Introduction

1. The integrated Fiduciary Systems Assessment (FSA) of the Nepal SSDP was carried out by the World Bank, as part of AF Program preparation, based on the requirements of the World Bank policy and procedures for the PforR AF. Based on the analysis of available documents and working sessions with the key stakeholders, the FSA considers whether the Program’s fiduciary systems provide reasonable assurance that the financing proceeds will be used for intended purposes, with due attention to the principles of economy, efficiency, effectiveness, transparency, and accountability. It covers the Program’s institutional arrangements, FM and procurement systems, and governance systems.

2. The FSA was conducted based on knowledge of Nepal’s public procurement and FM systems in the current context of federalism. The World Bank fiduciary team met with the concerned federal government agencies including the OAG and the FCGO. The World Bank team also conducted fiduciary assessment of the select LGs (both municipality and rural municipality) as most of the SSDP activities are now implemented by the LGs. Given the capacity and system constraints at the LGs, the FSA concludes that only upon implementation of the agreed fiduciary mitigation measures, the Program’s fiduciary systems will provide reasonable assurance that the financing proceeds will be used for intended purposes. The proposed AF focusses on system strengthening at LGs through effectiveness conditions and DLRs.

II. Program Description, Institutional Arrangements, and Expenditure Framework

A. Program Description

3. The PDO of the parent IDA program is to improve the quality, equitable access, and efficiency of basic and secondary education in Nepal by supporting the Government’s SSDP Plan. The proposed AF will not include a change in the original PDO or the three results areas. The program boundary and the results area will remain unchanged. The proposed AF would help the GON reduce its financing gap in supporting SSDP activities and help complement capacity and system strengthening activities. The AF, however, would entail adding selected new DLRs and introducing a new DLI within the existing program boundary. The proposed AF will be for a three-year operation (2018–2021) and the design will be aligned with SSDP PRF targets. It would be directly tied to activities related to support LGs in quality service delivery with a view to protect and enhance education service delivery with strengthened controls during the ongoing federal transition.

4. The AF comprises two parts: (a) a fixed part (60 percent of the total grant) based on the country’s compliance with the three eligibility requirements—having a credible education sector plan, commitment to financing the sector plan, and availability of critical data for sector monitoring and analysis—and (b) a variable part (40 percent of the total grant) conditional on achieving the targets for three pre-identified ‘stretch’ indicators associated with equity, quality, and efficiency in the education sector.

B. Institutional Arrangements

5. The SSDP will use the government system (federal and local) for program implementation, oversight, FM, procurement, environmental and social systems, M&E, and reporting arrangements. The MOEST will serve as the executing agency and will have overall responsibility for policy guidance and oversight for program implementation. The newly established CEHRD will serve as the main implementing

agency. In addition to preparing ASIPs and AWPBs, the CEHRD will provide oversight and technical support to LG units in carrying out program activities.

C. Expenditure Framework

6. The Program’s Expenditure Framework (PEF)¹ will be entirely funded through the GON’s National Budget and will be implemented through the use of the GON’s systems, both federal and local, with regard to budget preparation and execution, cash management, accounting, financial reporting, internal controls, and external audits. The federal government budget is considered a credible predictor of actual expenditures because the difference between actual and original budgeted expenditure is generally below 5 percent. The activity-based budgeting has commenced with LMBIS from FY2018/19, including for the fiscal transfers in the form of conditional grants transferred to the LGs, which constitutes significant amount of the SSDP activities, which are implemented by MOEST/CEHRD. However, the procedures for LGs reporting on the conditions met/activities implemented under the conditional grants are not yet established. While the activity-based classification in the budget framework of the federal government is in place, lack of systems and procedures in the federal context do not yet allow for execution monitoring of the budget proceeds.

7. The World Bank proceeds will be transferred to the GON’s consolidated fund (the General Fund) at the Nepal Rastra Bank (NRB) and fund the execution of the GON’s budget. The IMF safeguards assessment mission of 2017, while making important recommendations to improve the internal control framework of the NRB, has not indicated that specific safeguards measures would be required.

8. At the end of the SSDP, any amount exceeded by the total DLI disbursed amount by the World Bank compared to the total expenditures incurred under the defined Program minus other donors’ contributions will need to be refunded to the World Bank. According to the FY2018/19 approved budget, a total of NPR 7,555.6 million has been provided under the SSDP source against 350140 SSDP - central level. Under the same, 26412 Conditional Recurrent Grant NPR 882.7 million and 26422 Conditional Capital Grant NPR 793.6 million have been provided. Out of this, NPR 5,452.6 million is from the Government, NPR 1,038.8 million and NPR 1,064.2 million is from Donor Grant and Credit source, respectively. A large share of SSDP budget is released to LGs through the Ministry of Federal Affairs and General Administration (MOFAGA). Information about provincial- and local-level allocations through MOFAGA were collected from the CEHRD planning sections and is recorded in table 6.1. The detailed breakdown of each head released to MOFAGA will be further confirmed and made consistent with table 6.2 once the AWPB under finalization is shared.

Table 6.1. SSDP Budget Allocation for FY2018/19, NPR

Budget Headings	New Budget Headings	Name of the Activity	Local Level Allocation	Province Level Allocation	Center Level Allocation	TOTAL
350016-3	350016	Basic and secondary level teacher salary grant	59,915,919,000			59,915,919,000
350017-3						
350023-4						
350140-3	350140	SSDP Center			7,555,600,000	7,555,600,000
350140-4						

¹ A complete description of the PEF is found in annex 2 and is not repeated here.

350023-3	350806	SSDP District	25,202,239,000	267,150,000		25,469,389,000
350806-3						
350806-4						
TOTAL School Sector Budget						92,940,908,000
TOTAL SSDP Budget excluding teachers' salary						33,024,989,000

III. Program's Fiduciary Performance and Significant Fiduciary Risks

A. Financial Management Systems

9. The Program's FM implementation arrangements have been assessed to evaluate the capacity of the implementing agency to record, control, and manage all Program resources and produce timely, understandable, relevant, and reliable financial information for stakeholders.

Program Planning, Budgeting, and Transparency

10. Nepal's education budget is based on an item-based administrative classification complemented with an economic classification. With the introduction of LMBIS from FY2016/17 for budget preparation, efforts for function/activity-based budgeting have been initiated. This better links budget allocations to policy targets and is thus expected to improve monitoring of expenditures in relation to budget/cost effectiveness and efficiency. However, as the activity-based budgeting is not yet extended to accounting, reporting, and monitoring, the advantage of such a budget framework is yet to be realized.

11. In the federal context, the SSDP budget spread among 761 entities (MOEST, CEHRD, and 753 LGs) and approximately 28,000 community schools is a significant challenge during the planning and budget preparation phase. The budget for fiscal transfers to LGs, that is, conditional grants for the SSDP specifying each activity to be spent on, was prepared at the ministry level with no inputs from the LGs as LGs were in the process of being operationalized at the time of budget preparation. Upon development of systems and capacity at LGs, it is expected that fiscal transfers for the SSDP may flow in the form of an unconditional grant, that is, equalization grant. The effective budget planning and preparation based on MTEF at LGs' level may take significant time to be realized given the capacity constraints. Even at the federal level, the annual budget continues to be prepared on an incremental basis without sufficient consideration for sector strategies and results reflected in the MTEF. These issues will be addressed to some extent during the SSDP implementation in the annual budget preparation of the MOEST with revised estimates based on program results/policy targets. Also, data available for teachers and students in the EMIS, which is fed at the school level, will greatly enhance quality of budgeting and planning. This will be encouraged in SSDP implementation along with institutionalizing the web-based EMIS data.

12. The SSRP financial and physical projections were made using Excel sheets and no standardized model was used. The SSDP intends to strengthen the MTEF process and make physical and financial projection more credible. The MOEST/CEHRD capacity will be developed for this.

13. Most expenditure under the SSDP will go toward salaries and remuneration (estimated 65.3 percent), followed by Program costs (27.2 percent) and management and administrative cost (7.4 percent). Under Program costs, the main costs include civil works (5.3 percent), textbooks and learning materials (6.7 percent), and scholarship and incentives (6.0 percent), accounting for an estimated 18 percent of total SSDP costs. The budget estimated for training and capacity development of staff, managers, and teachers amounts to only 2.7 percent of the total. In addition to fiscal transfers, LGs also allocate additional budget to school development from internally generated resources. The SMC is

involved in planning, management, and raising additional resources (not reflected in government budget and execution report) from the community as the GON resources are not sufficient for school development. While the OAG audit covers all the ministry-level and LG-level expenditures under the GON funds to individual schools, provision of school-level social and financial audits cover the audit of all funds/expenses at schools. Given the changed context, a grant management system that incorporates required controls including monitoring and reporting requirements will be developed for LGs. The important control measures such as social and financial audits, as required by law, will be strengthened further. The proposed AF includes DLRs on public disclosure by LGs of the tranche released to schools and expenditures incurred (by LGs/schools related to the SSDP) as per the Grant Management Guidelines.

Program Accounting and Financial Reporting

14. The FSA identifies major weakness in recording and reporting of SSDP expenditures given the changed context of significant expenditures being incurred at the LGs level. The MOEST has access to the Treasury Single Account (TSA) data, but the activity-based budget approved in LMBIS is not yet linked to or configured in the TSA. Thus, the disbursement to LGs from the federal government is only captured as conditional grant for the SSDP - central level. Consequently, the LGs are also reporting back the total conditional grant amount without disaggregating. The recently enacted Appropriation Bill for FY2018/19 does include provision for LGs to report back on the details on implementation period, status, and incurred expenditures for conditional grants. Apart from the one-fourth amount to be disbursed to LGs at the beginning of the year, subsequent disbursements are to be based on the details provided by the LGs to the DTCO on a trimester basis. However, the GON is yet to develop procedures for implementing this legal requirement. The development and implementation of such procedures by the federal government ensuring reporting by LGs of intended purpose usage of the Program funds is proposed as an effectiveness condition of the AF.

15. For the federal-level expenditures, the TSA can track expenditures incurred as per the economic classification. However, the challenges of reconciliation between the FCGO (TSA data) and MOEST/CEHRD accounts continues mostly due to the manual accounting and reporting system of the MOEST/CEHRD. It has been agreed to implement the FCGO-developed Computerized Government Accounting System for the Central Government in the MOEST/CEHRD from the current FY2018/19. The development of the plan for implementing the Computerized Government Accounting System was one of the DLRs in the Parent IDA program, which is already met.

16. The FCGO has developed a web-based budgeting, accounting, and reporting system for LGs, named SuTRA. Around 250 LGs out of 753 have implemented SuTRA. As SuTRA is based on the revised Chart of Accounts and produces reports as per FCGO requirements, it was noted that unless the remaining LGs also implement SuTRA, it will take time for the federal government to obtain timely required information from LGs given their manual accounting or accounting system that does not produce reports as per FCGO requirements.

17. At the school level, most school accounts are prepared manually with a simple consolidated income and expenditure statement produced end of the year. From FY2018/19, LGs are expected to obtain periodic information from schools to enable reporting to DTCOs on trimester basis in the required format. In institutionalizing this, in addition to the procedures to be developed by the MOF, it is important to include such provision in the Grant Management Guidelines of LGs.

18. The FCGO manages the consolidated fund of the Government at NRB (central bank of Nepal) through a network of DTCOs. The DTCOs make the payments based on the government entities' payment instructions and maintain accounts thereof in the TSA system computerized throughout the country. The accounting information is centralized at the FCGO, which produces consolidated annual financial statements of the State. These annual financial statements are published on the FCGO website. Although activity-based expenditure information is not yet produced by TSA, budget and accounting information has become more transparent after the implementation of Government Finance Statistics (GFS) classification and the TSA. Progress has also been made in piloting the Nepal Public Sector Accounting Standards in some of the ministries, which are compliant with international financial reporting standard (cash-based IPSAS). The rollout of the Nepal Public Sector Accounting Standards in the MOEST will be supported under the SSDP.

19. At the end of the Program, timely reconciliation of accounts/records will be ensured, supported by the TSU at the CEHRD, including for settlement of accounts and refund to the World Bank if required.

Treasury Management and Funds Flow

20. Line ministries are provided reliable information on commitment ceilings in advance, at least quarterly. Rule 32 of the Financial Procedures Regulations, 2007, states that after the enactment of the Appropriation Act, the Finance Secretary will send the budget statements and authorization letter to the secretaries of ministries, and the secretaries of ministries will send to departments and offices similar authorization letters, approved programs, sources of expenditure, and detailed line items within 15 days of receipt of the MOF authorization. Priority 1 projects (80 plus of total budget) are assured one-third of funds from the approved budget on the very first day of the fiscal year and expenditure funds are replenished on the day the statement of expenditure is submitted to the DTCOs. Likewise, for Priority 2 and Priority 3 projects budget lines are assured one-sixth or an amount equal to two months of the approved budget value.

21. Upon enactment of the Appropriation Act by the parliament, a statement of programs and projects with the ceiling of the budgeted amounts (the Red Book) is issued simultaneously. The Red Book provides ministries with reliable indication of actual resources available for commitment more than one and half months in advance.

22. There are transparent legal provisions for adjustment and virement from one budget heading to another and one source of financing to another. Nevertheless, the amount and number of in-year budget transfers is significant, as evidenced by the 2015 PEFA assessment.

23. Substantial progress has been achieved in the last few years with regard to treasury management and funds flow in Nepal with the implementation of the TSA system. This system has reduced the number of bank accounts controlled by the Government (from 14,000 accounts for 4,500 cost centers to around 400, controlled by DTCOs) and integrated them into a TSA. This allows for real-time monitoring of budget expenditures and the monthly publication of budget execution reports on www.fcgo.gov.np/publications. All budgeted public expenditures are captured across all the districts. The TSA comprises a revenue collection module (RMIS) now covering more than 90 percent of government budgeted revenues. This system is IT based and has strengthened ex ante budget controls, the credibility of budget execution data, and the knowledge of Treasury cash position and forecast. The introduction of commitment recording will further strengthen cash forecasting, planning, and budgeting.

24. Fiscal reports are publicly available; however, the fiscal reports are not comprehensive and many autonomous government agencies and donor projects operate outside the government budget and accounting framework. This is also the case for the education sector where some portion of donor funding for government projects are not captured by the government budget and disbursed outside the government Treasury system, that is, disbursements made directly to project accounts operated by the government agencies directly without passing through the TSA revenue accounts.

25. For budget execution, the flow of funds is entirely under the control of the FCGO. Line ministries, such as the MOEST, send payment orders to the DTCO, which processes payments through its network. In case of SSDP activities to be implemented by LGs, starting from FY2017/18, DTCOs make conditional grant payments to the LGs based on approved budget on trimester basis, hitherto without any utilization report from LGs except for the total conditional grant expenditure amount. The LGs disburse the same to the concerned schools based on their payment request, which is also without any utilization report from the schools. LGs maintain a record of teachers and students in the form of EMIS, based on which payments are made to schools' bank accounts. The school then makes transfers from the school bank account to teachers' bank accounts or withdraws cash for direct payments to teachers/students who do not have bank accounts.² The payments to vendors are usually done through checks by schools. To comply with the reporting requirement of grant utilization as provisioned in the Appropriation Act, use of SuTRA has been intensified through capacity building. It is expected that all LGs would implement SuTRA by the end of FY2018/19. However, to manage the possible risk of delays, the Federal Government has also constituted District Education Units under CEHRD as an interim arrangement, which will work closely with the LGs to facilitate collection of data on grant utilization and upward reporting. In addition to this, the Audit Report of individual LGs being carried out by the OAG will also provide information about the grant utilization at LGs. DP's Technical Assistance team is also working closely with the Government to agree LGs' common reporting formats.

26. It is noted from the OAG audits that schools in some cases do not follow the rules or purpose for which they received the grant. Unspent balances of a grant from one year to another appear to be treated as unconditional for purposes of expenditure. Government has agreed to establish a grant management unit (GMU) within each LG. MOEST/CEHRD will request LGs to assign responsible agent to monitor and report on grants. CEHRD is developing guidelines for grant management.³ In addition, the FM Unit within the CEHRD will be strengthened for overall financial monitoring of SSDP and ensuring timely implementation of recommendations from the OAG and other agreed actions.

Program's Internal Controls, Including Internal and External Audit

27. While there is no national framework especially for internal controls in the public sector in Nepal, there is comprehensive set of financial regulations guiding budget execution that includes elements of internal controls. However, weaknesses in enforcement of these rules, largely due to lack of accountability as well as capacity constraints at the CEHRD have created challenges in maintaining fiscal discipline and compliance with these regulations. The capacity and systems constraints at the LGs' level have now exacerbated the challenges. The expenditure management does not provide for sufficient ex ante controls to prevent expenses from being incurred in contradiction with the legal and regulatory framework. The DTCO internal audit function for the federal level is an ex post sample testing of the existence of supporting documentation (invoices and so on) available at cost centers in support of the payment

² During the time of this assessment it was estimated that more than 80 percent of teachers have bank accounts and the target is to have all teachers receiving their salaries through bank transfers.

³ MOEST. Presentation- Transitional Roadmap for the Implementation of the SSDP in the Federal Setup. October 2018.

requests processed by the DTCO. This 'inspection' takes place infrequently due to capacity constraints of the DTCO. In addition to frequency and quality of internal controls, the institutional arrangement with limited segregation of duties for internal audit under DTCO which also functions as payment processor presents challenges on integrity of control function of the internal audit. For LGs, internal controls and internal audit functions are yet to be developed. LGs are in the process of adopting the model financial procedures issued by the MOFAGA. However, they are generic and not sector specific. To address this, it is specified in Provision 1.2 of the model 'Local level Budget Preparation, Implementation, Financial Management and Asset Transfer Directives, 2074' that for conditional grants, the local level will coordinate with relevant units under them (schools in this case) and the district office to spend for the specified purpose, the details of which will be provided by MOFAGA in coordination with the relevant ministry. Therefore, this detailed sector-specific guideline is required to be issued in coordination of MOFAGA, MOEST, and FCGO. It has been agreed that these guidelines will be issued by December 31, 2018. To ensure implementation of these by LGs, the federal government will include these requirements in the Guidelines of the Conditional Grants to LGs.

28. Given the various challenges in the sector and the nature of program interventions that disburses funds and resources to a large number of beneficiaries, some of the SSDP expenditures are reported as questionable by the OAG in its annual audit reports. The recurring observations from the past OAG audit reports include the following:

- (a) Excess salary payment to teachers—for teachers who have already retired and in excess of entitlements
- (b) Significantly delayed work completion certification for construction and repairs/maintenance of schools
- (c) Noncompliance of procedures for distribution and monitoring of scholarships
- (d) Excess disbursement for free textbooks
- (e) Conditional or earmarked grants to schools not used for the intended purpose
- (f) Expenses incurred without adequate supporting documentation often related to travel, workshops and training as well as stationery and other inputs at school level.

29. The agreed actions noted below would mitigate the risks: (i) continuity of the Grant Management System established at the District Education Offices in the parent program (prior to the federal transition) at LGs level in federal set up - a requirement for reimbursement of SSDP *DLR 1. 2: Grant Management System Operational*; (ii) requirement of GPE DLRs 1.8, 1.10 and 1.11 to establish GMS at LGs.

30. On the positive side, the latest audit reports since FY2014/15 show significant progress. For example, the audit opinion is not qualified unlike in the previous years, the number and nature of audit observations have decreased from the previous years (for example, there are no audit observations on nonexistent 'ghost' schools and per capita funding), and a large portion of the audit observations raised in the previous fiscal years has now been settled (these include settlement of excess salary payment to teachers, textbooks and other per-capita grants). The audit report of FY2017/18 was also received within the due date of nine months from the FY end and there is no audit report overdue. While this reflects efforts made toward improving fiduciary systems, much remains to be done to address identified risks reflected in the recurring audit observations on excess salary payments, excess payment for textbooks,

scholarships, and non-availability of work completion reports. These risks have become more pronounced in the federal context while the parent IDA program has reduction of audit observations has one of the DLIs. Capacity constraints at the central level, particularly for monitoring and supervision, are also a major weak area given the increase in number of implementing agencies. The capacity building at the central level is also one of the DLRs in the SSDP. With regard to refund of the ineligible expenses of final year of SSRP (FY 2015/16), MOEST has refunded the proportionate share of the ineligible expenses to the Bank.

31. The proposed AF has made special arrangement to address the above challenges on fiduciary management at the LGs by having the LGs incorporate the required controls in their Grant Management Guidelines, which is one of the DLRs. LGs will only make tranche payments to schools based on verification of compliance with the provisions of the Grant Management Guidelines, which should include the following:

- (a) Verification of eligible schools, teachers, and students' data in EMIS.
- (b) Reconciliation of EMIS and Teacher Record Office (TRO) data. The federal government will share TRO data with each LG for reconciliation purpose.
- (c) Verification of teachers' salaries paid into bank accounts to the extent possible (in consideration of remote location of schools). The field created in the EMIS for entering 'Teacher's Bank Account No.' should be duly used for this purpose.
- (d) Review of expenditures incurred by schools (for previous tranche releases) based on expenditure statements obtained from schools. A dedicated focal person will also be assigned by the SMC to coordinate the school reporting.
- (e) Review of social audits and financial audits of the schools. The Grant Management Guideline should specify the periodicity and timeline of obtaining such reports.
- (f) Verification should be based on physical inspection or supporting documents as appropriate.

32. Each tranche release to schools from LGs and expenditures incurred (by both LGs and schools for the SSDP) will be publicly disclosed by each LG. In addition, supporting document evidencing verification conducted by LGs before each tranche release will also be publicly disclosed by LGs. This requirement is included in the proposed AF's DLR. To ensure implementation of these by LGs, the federal government will include these requirements in the Guidelines of the conditional grants to LGs.

Program Audit

33. The OAG conducts financial audit of all federal and local government expenditures. It also conducts random performance audits. These performance audits are reported in the annual report of the OAG. As per the JFA and parent IDA program, the audit report for the SSDP is to be submitted within nine months from the end of the fiscal year. The same will apply for the AF. This timeline was met in the last fiscal year audit of 2017/18. However, given the present context of the SSDP being implemented by LGs and audit of LGs to be completed for a consolidated SSDP audit report, it is noted that the completion of audit may take time. The World Bank will closely monitor and follow up with the OAG for timely audits. The OAG capacity-building initiatives on risk-based audits financed by the PFM Multi-donor Trust Fund (MDTF) are also expected to reduce audit time in the long term. The OAG has agreed to provide audit opinion on the consolidated SSDP audit report incorporating findings of all SSDP-related expenditures

incurred by LGs. The audit will also report on the intended purpose utilization of the funds and the eligibility of expenditures incurred as defined in the Program.

B. Procurement Systems

Arrangements for Procurement under the Program

Legal Framework

34. The CEHRD is responsible for overall procurement management under the SSDP, including procurement planning, implementation, supervision, reporting, and database management. The CEHRD's procurement is governed by Nepal's Public Procurement Act (PPA0, 2007), Amendment-1 and Public Procurement Regulations (PPR0, 2007) made thereunder. The Public Procurement Monitoring Office (PPMO) is responsible for procurement policies and oversight of all procurement agencies including the CEHRD/MOEST. Under the present legal framework, open tender is mandatory for procurement of goods, works, non-consulting, and consulting services above NPR 2 million (for medical equipment, above NPR 5 million), whereas sealed quotations are permitted for procurement up to NPR 2 million (for medical equipment, up to NPR 5 million). The CEHRD has to follow these regulations as well as any other directions of the PPMO.

Procurement Planning

35. Because of the federal structure and devolution of expenditure authority to the lower-level governments (provincial and local-level governments), volume of procurement will be substantially reduced at the center (CEHRD). Under the Program, the CEHRD will prepare a Consolidated Annual Procurement Plan (CAPP). The Procurement Unit at the CEHRD coordinates the preparation of the CAPP, based on procurement needs of the CEHRD and other central line agencies), that is, CDC, MOEST, and so on. The Program and Budget Section and Financial Management Section of the CEHRD and respective CLAs play a key role in preparing the program's AWPB and once the AWPB is finalized, necessary changes are made in the CAPP. The final CAPP is then submitted to the PPMO, which publishes it on its website. The CEHRD also publishes the CAPP on its website.

36. **IDA PforR exclusions.** The Program (PforR-supported activities) will exclude activities that involve procurement of (a) works, estimated to cost US\$10 million equivalent or more per contract; (b) goods, estimated to cost US\$5 million equivalent or more per contract; (c) non-consulting services, estimated to cost US\$5 million equivalent or more per contract; or (d) consultant services, estimated to cost US\$3 million equivalent or more per contract. In addition, the Program will exclude activities that are likely to have significant adverse impacts that are sensitive, diverse, or unprecedented on the environment and/or affected people, and that involve reconstruction of schools in 31 earthquake-affected districts by the National Reconstruction Authority.

Major Observations on the CEHRD's Procurement Management

37. Based on the experience of the parent IDA program implementation at the CEHRD, formerly the DOE, the following main issues have been identified.

Structural Weakness

38. The Procurement Unit within the CEHRD is led by a Deputy Director of the General Administration Section, who is an administration professional. Director General and Directors are education professionals. All other officers working for the Procurement Unit are also administration professionals. Over the period of implementation of the SSDP parent project, it has been observed that all these professionals working for the Procurement Unit did not have adequate procurement knowledge, experience, and skills. Though the parent IDA program and the proposed AF do not have procurement intensive operations, timely preparation of CAPP has always been an issue. Considering the role of the CEHRD in managing entire procurement for the project, there is a need for an experienced procurement professional. Civil servants, by nature, are not considered to mandatorily have procurement knowledge and experience. Also, they are being transferred regularly and in some cases, very frequently, and by the time they gain some procurement knowledge and experience they get transferred. To manage this situation and mitigate the risks, outsourcing of a procurement expert with intermittent input is a must to provide continuous procurement support to CEHRD/Procurement Unit.

Delays in Procurement Decisions

39. Finalization of the CAPP itself takes considerable time. Similarly, procurement decisions at every level are delayed for various reasons. There is no procurement monitoring system to see whether timely decisions are taken or not. It has been observed that a number of procurement items are bunched in the last quarter of the year.

Management of School Physical Facilities Implemented by the CEHRD

40. **Selection of schools and allocation of SPFs.** Based on EMIS data, the CEHRD prepares the AWPB and allocates budget for construction of SPFs, which includes construction of classrooms and toilets, supply of classroom furniture, and repair and maintenance of these facilities. Budget is allocated for LGs and each LG releases budget to schools, which are selected based on the approved criteria and procedure mentioned in the centrally prepared Program Implementation Manual. From the implementation of the SSDP and previous projects, it has been observed that there is no adequate and ready-to-refer information on the status of school-wise allocation of physical facilities and their completion status. For various reasons, including mainly delay in budget release and finalization of school selection, SMCs are facing difficulties in completing construction works within the same fiscal year. Therefore, cases of audit observations in construction works are substantial. Respective SMCs are responsible for construction and repair and maintenance of SPF based on community procurement modality at schools. Construction materials such as bricks/stones, cement, steel, wood, and others are procured locally comparing the prices in the local market within the framework of PPA/PPR. Labor required for the construction works is either managed through labor contracts or through force account method. The school has to maintain proper documentation of procured items with invoices. These invoices are checked by LG engineers/sub-engineers to verify the reasonableness of the prices at the time of certifying for payment or release of next installment.

41. **Technical supervision support for SPF.** LG-based engineers and sub-engineers are providing engineering support in selecting schools and supervising construction and repair/maintenance works. It has been observed that such engineering manpower is not adequate to provide timely and quality support to schools. The CEHRD has to prepare a plan for arranging engineering support to every LG based on need assessment, considering the number of SPFs in the LGs, remoteness, and geographical location. A rationalized manpower requirement should be developed for Terai, hill, and mountain regions, and manpower and budget should be arranged accordingly.

42. **EMIS for capturing status of SPF.** The current EMIS is still Excel based, though it was agreed to make it web based. The process should be expedited to upgrade it to an online web-based system, which can be easily done given the current level of readiness of the EMIS software. As described above, LG/district-wise list of schools with the number of allocated facilities per school should be uploaded in the MOEST/CEHRD/LGs soon after the first tranche of the budget is released. Completion status of these facilities should also be uploaded in the same manner for each completed facility. The information should subsequently be linked with the EMIS. Considering the difficulty in completing the construction work in the same fiscal year due to delays in selection of schools and allocation of SPF, it is reasonable to provide two fiscal years of time for completing SPF. Except for some special cases of multiyear construction, if any SPF is not completed within the two consecutive fiscal years, they would not be considered as completed facilities under the IDA PforR Program.

Management of SPF Implemented by NRA in 31 Earthquake-affected Districts (Outside the IDA PforR Program)

43. All SPF, except repair and maintenance as described above under CEHRD implementation, will be planned, implemented, and reported according to the procedure agreed with the NRA for the ADB and JICA-financed components. The MOEST/central level project implementation unit (CLPIU) is responsible for overall coordination and implementation management to ensuring timeliness and quality of the implementation. Repair and maintenance of SPF in schools of these districts will however be carried out by the CEHRD as mentioned above under CEHRD implementation.

Construction of Office Buildings

44. Construction of office buildings will follow standard procurement procedures under the PPA and PPR including adequate arrangement for design and construction supervision. Procurement of construction works at province and local levels is done by respective governments using the PPMO's eGP portal, as provided by PPMO. The CEHRD, in coordination with the MOEST, is responsible for providing procurement support and training for LGs' engineering manpower for construction works. As an additional due diligence on quality of the construction works, it is recommended that the CEHRD or LGs carry out technical audit of such buildings in a sample basis.

Value of Procurement Done by the DOE

45. The value of procurement administered by the DOE during FY2015/16 and FY2016/17 is as indicated in table 6.2 (NPR in millions):

Table 6.2. Budget Allocation by Procurement Activities

Sl. No.	Description of Procurement Activities	FY2015/16	FY2016/17
1	Procurement of goods (furniture and fixture, office equipment computers, printers, photocopiers, software and vehicles, and so on) done at the DOE level	111	149
2	Procurement of works for RED, DEO, and resource center building construction done at respective level	31	51
3	Procurement under consulting services	12	25
	Total value of procurement	154	225

Source: DOE now CEHRD

Note: Value of procurement done by other CLAs is small.

Table 6.3. Value of Grants for School Physical Facilities and Textbooks (NPR, millions)

Sl. No.	Description of Procurement Activities	Budget Allocated	
		FY2015/16	FY2016/17
1	School building and infrastructure support grants (grants for SPF)	10,729	7,414
2	Grants for textbooks	1,860	1,860
3	Total grants	12,589	9,274

46. From tables 6.2 and 6.3, it is evident that the volume of procurement is far below (less than 3 percent) of the total budget in grants for SPF and textbooks.

47. **Arrangement of textbook supply to schools.** There is a unique arrangement for supply of textbooks to public schools. Textbooks are not procured through competitive bidding procedure. However, a government-owned printing house—Janak Education Material Center (JEMC)—and some selected private printers-distributors (PPDs) are allowed to print and distribute textbooks on the prices fixed by the Government. While the JEMC is free to print and distribute textbooks for all grades and in all regions, PPDs have been allowed to print and distribute Grades 1–5 textbooks across the country. This arrangement, as a recent development, has created a competitive environment among the Government and private sectors to quickly print and distribute textbooks to secure their part of the job. Though there were several issues in the past, textbook outreach to students has considerably increased in recent years (more than 85 percent of students receiving textbooks within two weeks of the start of the academic session compared to around 50 percent during EFA). To forecast the need for textbooks every year, there is a special mechanism at the CEHRD-CDC which prepares a plan for printing textbooks and prepares a list of qualified private sector printing houses for this job. Then the CDC enters into an agreement with each of the selected PPDs, while the JEMC’s responsibilities (as a government agency) are defined in a separate document. The CEHRD, in coordination with the CDC, carries out regular monitoring of printing and distribution progress of textbooks. A 12-member monitoring team has been constituted for this monitoring. The list of PPDs is updated every year depending upon their performance. Similarly, there is a mechanism under the MOEST which is responsible for fixing the retail price of each textbook for each grade.

48. Public schools obtain grants for textbooks from respective LGs based on the number of students and the schools purchase textbooks from nearby authorized book stores.

C. Fraud, Corruption, and Debarment of Contractors

49. The main objective of the integrity review, as part of the integrated fiduciary assessment, was to confirm whether the legal framework and institutional mechanisms in place would enable MOEST to abide by the ‘Guidelines on Preventing and Combating Fraud and Corruption in Program-for-Results Financing.’

50. While there are weaknesses in accountability, the review of the status of integrity systems in the sector found that there is increasing recognition within the GON of challenges posed by fraud and corruption to development outcomes. This is seen in particular in the fact that the budget for the financial year 2016–2017, presented by the Finance Minister in late May 2016, had several paragraphs devoted to

anti-corruption.⁴ This notes that “...intensive monitoring will be made to end the improper and corrupted activities between beneficiaries and service providers...Middlemen will be under surveillance...Social awareness against corruption, recognition of zero tolerance against corruption and integrity will be promoted.” Moreover, resources will be assigned to this work, that is, “...The capacity of constitutional bodies related to investigation and prosecution will be developed. Necessary law, resource and manpower will be arranged.” This may indicate a renewed focus on these issues and suggests that resources may be assigned to this area, and to efforts to redress the weaknesses as described below.

51. The integrity review conducted during the fiduciary assessment found that there have been cases of investigation by the country’s anticorruption authority (Commission for the Investigation of Abuse of Authority [CIAA], a constitutional body) in the last few years. Receipt of grants by ‘ghost schools’ was under primary attention as it was flagged by the OAG in their annual audit reports.

52. **Local authorities.** The CIAA is a constitutional body created by the Constitution of Nepal 2015. Complaints are reported in a variety of ways, including, but not limited to, in person at the CIAA main office or district offices, by mail, by phone, by e-mail, or through the web link for the CIAA website (<http://ciaa.gov.np>).

53. The fiduciary review also found that the MOEST/CEHRD does not have specific preventive mechanisms in place to identify and prevent the types of misconduct defined in the Anti-Corruption Guidelines (ACGs). Improvements in this area are envisioned over the course of implementation of the IDA PforR, given its emphasis on improving internal and fiduciary systems. The review also noted that the MOEST/CEHRD system of internal control, including provision of collecting complaints especially with respect to procurement and use of SPF grants and addressing them systematically, is not effective in preventing recurrence of identified fraud and corruption issues.

54. **Ethics and code of conduct.** The review did not find a system that continuously supports and monitors a code of conduct in the MOEST/CEHRD. Monitoring of complaints is however done by the General Administration Section within the MOEST/CEHRD. This needs to be further strengthened and made effective.

55. **Whistleblower.** There are no organized avenues for civil servants to report fraud and corruption complaints anonymously, although they can use the various channels the public uses to report complaints to the CIAA.

56. In conclusion, it would be important to agree with the Government on a modality to share with the World Bank complaints received under the Program regarding fraud and corruption, given the weaknesses or lack of systems in this area, and the level of fraud and corruption risks at the sector level.

Summary of Significant Fiduciary Risks

57. Based on the assessment of fiduciary systems conducted in the above section, the following significant fiduciary risks have been identified for the Program:

- (a) There is a weak link between policy intent reflected in activity-wise budgeting in LMBIS and reporting from LGs, which only reflects the total amount of sector-wise conditional grants

⁴ The GON, Finance Minister Budget Speech, 2016, pp 54–55, para 363–366.

spent by LGs. This results in lack of evidence for intended purpose utilization of the Program Funds.

- (b) The capacity at the federal and local levels to assess the performance of the Program and manage results indicators is weak.
- (c) Weakness in the internal control framework within the federal level, with non-existent internal controls at LGs, poses a risk that World Bank proceeds might be expensed in contradiction with the legal and regulatory framework.
- (d) In particular, the complexity of the SSDP expenditure framework, with 761 cost centers and approximately 28,000 community schools and the lack of sufficient accountability mechanisms, is a risk. Federal parliamentary oversight and the capacity of the PAC remains fragile while the local parliamentary oversight is yet to be established.
- (e) Low capacity of the unit in charge of the MOEST/CEHRD procurement.
- (f) Inadequate and in some cases no capacity of LGs in providing engineering support to schools.
- (g) Some provisions of the country's public procurement law and legal framework have posed risks due to the requirement for increased performance security, contract termination, and recovery amount from the contractor, works procurement without qualification criteria up to the specified threshold, and so on.

58. Fiduciary systems also present elements of strengths that will constitute a sound basis for the Program if complemented by measures to strengthen it:

- (a) A sound government budget process with regard to timeliness, classification, and execution control by Treasury
- (b) Transparency of the budget process with monthly budget execution reports published on the FCGO's website and timely production and publication of budget documents and annual financial statements
- (c) A systematic external audit of federal and local government expenditures, including in the school sector, by an independent OAG and an increasing capacity of the OAG to conduct performance audit
- (d) Functional e-GP system of the Government which provides single portal for all public entities and accessible to all national and international bidders contributing to enhanced transparency, fairness, and competitiveness in bidding

IV. Mitigation Measures and Monitoring of Fiduciary Performance

59. The federal fiduciary systems are generally in line with international standards with regard to budget process and transparency. The challenges are mainly at the LGs' level with significant SSDP activities to be implemented by the LGs. DLRs 1.8, 1.10, and 1.11 under the AF aims to address fiduciary risks described above and serve as robust mitigation measures to institutionalize fiduciary systems and

capacity. The implementation of this will provide reasonable assurance that the financing under the Program will be used for the intended purposes as follows:

- (a) Development and implementation of the procedures by the federal government as effectiveness conditions in the AF for ensuring reporting by LGs on the intended purpose utilization of Program funds.
- (b) Incorporation of required controls for LGs in the Guidelines of the Conditional Grants issued by the federal government.
- (c) Incorporation of required controls in management of tranches to schools by LGs will be ensured by incorporating in the Grant Management Guidelines, implementation of which by LGs is proposed as a DLR in the AF.
- (d) All types of procurement of works are carried out using the model bidding documents acceptable to the Association.

60. Nevertheless, considering the existing weaknesses in Program fiduciary systems and the time and effort required to implement the above mitigation measures, the residual fiduciary risk rating for the Program is rated Substantial.

Mitigation Principles

61. The assessment suggests the following mitigation principles for Program implementation.

- The procedures developed and implemented by the federal government for LGs reporting back on the conditions met/activities implemented will ensure intended purpose utilization of the Program funds. This, being a prerequisite of AF and the parent IDA program, has been proposed as an effectiveness condition. Also, the OAG's financial and performance audits will provide assurance of intended purpose usage and eligibility of expenditures incurred.
- Fiduciary capacity building at all levels (including for monitoring and supervision) - federal, local, and school: TSU for supporting the MOEST and CEHRD; GMU at each LG and dedicated focal person for each school assigned by SMC to coordinate the school reporting.
- The required controls in LGs will be ensured by the Guidelines of the Conditional Grants issued by the federal government. As the grants to LGs are based on conditions, the conditions/activities will be added to ensure establishment of required internal controls in LGs.
- For tranche releases from LGs to schools, Grant Management Guidelines with required controls developed and operationalized by the GMU at each LG will ensure eligibility and timely reporting of all expenditures (salary and non-salary by schools).
- Establishment of a Fiduciary Management Committee chaired by the MOF, including key stakeholders of the MOEST as well as the FCGO and IECCD in the MOF and representatives from the OAG as required. The PEFA Secretariat will have a key role in ensuring coherence between the fiduciary strengthening program of the MOEST and PFM reforms led by the

MOF. This committee will meet once in 4 months in a year. It will provide strategic guidance and monitor progress including that of the agreed mitigation measures (DLRs).

- A system to share with the World Bank complaints received under the Program regarding fraud and corruption agreed with the Government.
- Preparation of a plan for arranging engineering support to every CEHRD based on need assessment considering number of SPFs in the district, remoteness, and geographical location. A rationalized manpower requirement should be developed for Terai, hill, and mountain regions. The plan should be approved by the CEHRD and manpower and budget should be arranged accordingly (MOEST/CEHRD and MOF).
- Engagement of a procurement expert with intermittent input through outsourcing (CEHRD).
- Upgradation of the current Excel-based EMIS to online web-based EMIS. The list of schools with the number of allocated facilities per school is uploaded in the LGs' MOEST/CEHRD websites soon after the first tranche of the budget is released by the LGs and DTCOs, respectively. Completion status of these facilities should also be uploaded in the same manner for each completed facility. This information is made public through appropriate arrangements so that people can access the information and make their comments and complaints.

The above risk mitigating measures will be included in Grant Management Guidelines, implementation of which by LGs is proposed as a DLR in the AF. The implementation of these requirements by LGs will be ensured by including such provisions in the Guidelines of the Fed