



Consultant's Report

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Nepal: Sector Level Risk Assessment and Risk Management Plan to Assess Public Financial Management, Procurement, and Corruption Risks in the Urban Development Sector

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Asian Development Bank

ACRONYMS

ADB	Asian Development Bank
CAP	Community Awareness Program
CBS	Central Bureau of Statistics
CDO	Chief District Officer
CIAA	Commission for the Investigation of Abuse of Authority
CIM	Center for International Migration and Development
CPI	Corruption Perception Index
CPS	Country Partnership Strategy
CSO	Civil Society Organization
DAO	District Administration Office
DDC	District Development Committee
DED	German Development Service
DFID	Department for International Development
DMCs	Developing Member Countries
DoR	Department of Roads
DSA	Debt Sustainability Analysis
DUDBC	Department of Urban Development and Building Construction
DWSS	Department of Water Supply and Sanitation
EA	Executive Agency
EDC	Engineering Design Consultant
EIA	Environmental Impact Assessment
FCAN	Federation of Contractors' Associations of Nepal
GACAP	Governance and Anticorruption Action Plan
GDP	Gross Domestic Product
GHG	Green House Gas
GLOF	Glacial Lake Outburst Flood
GoN	Government of Nepal
GTZ	German Technical Cooperation
IAP	Integrated Action Plan
ICB	International Competitive Bidding
ILO	International Labor Organization
IPT	Integrated Property Tax
KfW	German Development Bank
KMC	Kathmandu Metropolitan City
LBFAR	Local Bodies Financial Administration Regulations
LDF	Local Development Fee
LDO	Local Development Officer
LGCDP	Local Governance and Community Development Program
LSGA	Local Self-Governance Act
MC	Minimum Conditions
MCPM	Minimum Conditions and Performance Measures
MIS	Management Information System
MLD	Ministry of Local Development
MoF	Ministry of Finance
MPPW	Ministry of Physical Planning and Works
MuAN	Municipalities Association of Nepal
NCB	National Competitive Bidding
NGO	Non-government Organization
NPC	National Planning Commission

NVC	National Vigilance Center
OED	Operations Evaluation Department
PCO	Project Coordination Office
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PIU	Project Implementation Unit
PMO	Project Management Office
PPP	Public-Private Partnership
PPPUE	Public-Private Partnership for the Urban Environment
PPR	Public Procurement Regulations
PRS	Poverty Reduction Strategy
RBN	Road Board Nepal
RPM	Risk Management Plan
RSDD	Regional and Sustainable Development Department
SDC	Swiss Agency for Development and Cooperation
SOE	Statement-of-expenditure
SWAp	Sector Wide Approach
TDCs	Town Development Committees
TDF	Town Development Fund
TYIP	Three Year Interim Plan
UDLE	Urban Development through Local Efforts
UEIP	Urban Environmental Improvement Project
UG	User Group
UNDAF	United Nations Development Assistance Framework
UNDP	United Nations Development Programme
VDC	Village Development Committee
WB	World Bank
WFP	World Food Programme
WTO	World Trade Organization
WUSC	Water Users and Sanitation Committee

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EXECUTIVE SUMMARY

01. The Asian Development Bank (ADB) is in the process of developing the Country Partnership Strategy (CPS) for Nepal in consultation with the Government of Nepal (GoN) and other stakeholders. The CPS is informed by a number of pre-CPS diagnostic studies for sectors where ADB is active. This document, which assesses the public financial management (PFM), procurement, and corruption risks in the urban development sector, and prepares the necessary risk mitigation plan in line with ADB's Guidelines for Implementing the Governance and Anticorruption Action Plan II (GACAP II), is part of a series of background assessments and diagnostics commissioned by the ADB. The findings, risks assessments and risks mitigation plans of this study, pertaining to the urban development sector of Nepal, are primarily based on: i) literature review, web search and updating and ii) primary research mainly comprising interviews and consultations with officials in government ministries and agencies, donors, municipalities and related projects.

02. Nepal, which emerged from over a decade long civil war, is in a post conflict transitional period. During the conflict, rapid growth in urban population due to migration and displacement of rural people to urban areas and destruction of urban infrastructure, challenged municipalities' capacities and ability to perform. The movement of people from rural to urban areas in search of better livelihood prospects and opportunities continues unabated putting severe pressure on the limited capacities of municipalities to provide basic services to its denizens.

03. The growth of the urban sector, and its implications, have not been understood well and adequately addressed by policy makers and planners. Owing to insufficient financial resources, lack of qualified human resources, and low institutional capacity, urban authorities are also unable to keep pace with the growing demand for services with commensurate infrastructural facilities and good governance.

04. Governance issues have been a major factor undermining the effectiveness of municipality spending. These are characterized by, among others, excessive involvement of political parties during selection and implementation of projects; and increasing level of fraud, mismanagement, and corruption. In general, mobilization of financial resources by municipalities is hampered by lack of a sound financial management system and innovative approaches to develop institutional capacity to manage their financial affairs. Municipalities' revenue is usually overestimated to match budgets for capital and current expenditure. The tendency for an annual increment in revenue targets by a certain percentage without a systematic assessment of the portfolio is prevalent. However, in reality, revenue generally falls short of planned targets, thus, adversely affecting expenditure outruns. Systems on how to complement development plans with financial plans, assess potential resources, assess and collect tax, and carry out accounting and auditing exercises are weak and need major improvement.

05. Transparency in financial management also varies among municipalities. A multi-year perspective in fiscal planning, expenditure and budgeting (preparation of multi-year fiscal forecast and functional allocations; scope and frequency and debt sustainability analysis (DSA); existence of sector strategies with multi-year costing of recurrent and investment expenditure; linkages between investment budget and forward estimates) are not normally practiced by municipalities. Internal audit units are also not in place in most of the municipalities, and a backlog of audits is quite common.

06. All procurement constraints in evidence at the national level are also exhibited in the urban development sector. Municipalities follow the Public Procurement Act (PPA) but do not have proper procurement plans and are not guided by specific procurement

manuals. Also, awareness of the basic elements of the PPA and the improvements made in procurement procedures is low in municipalities. There is a relatively limited degree of integration of procurement plans in the overall financial management system. The following grey areas, related to procurement, are apparent in the urban development sector:

- The ratio of bids submitted to documents distributed is very low, usually with submissions just meeting mandatory requirements.
- Collusion is rampant with successful bids very close to the budgeted provision;
- The practice of technical audits is nominal and there is low level of monitoring of procurement works.
- Threats, intimidation, and extortions are common practices.

07. Several inter-related factors contribute to the growing corruption problems in the urban sector. The most significant of which are:

- i) A lack of transparency and access to information that surrounds many municipal functions and undermines nearly all aspects of accountability. This has hindered citizens' participation in policy discussions and oversight of municipality functions;
- ii) Highly politicized administration, especially the appointment of the chief executive officer and division of staff along political lines and the existence of a "spoils system;"
- iii) Limited political will and leadership to actually implement required reforms in accordance with the law; and
- iv) Weak internal control systems within municipalities.

08. The culture of reporting corruption cases and complaining against irregularities is low with the tendency of accepting petty corruption as a mean to get one's work done ingrained in the people's mindset. Most people go by the dictum that it is wise to get one's work done on time by bribing officials rather than lodging complaints to higher authorities. As collusion between the boss and subordinates is a common practice, people's faith on the success of complains and improvement in services is nominal. As a result, the incentive to complain against corruption and irregularities is highly eroded.

09. In Nepal, many of the systems and policies, and Acts are not well adjusted to address the issue of climate change. Critical urban infrastructure, that are vulnerable to extreme climate conditions, are not designed with climate change predictions in mind. The Environmental Impact Assessment (EIA) processes of infrastructure projects do not explicitly require consideration of climate change impacts. There is limited capacity to include climate change considerations in project designs and into the existing EIA process. Consequently, projects are not being fully assessed from an overall ecological sustainability perspective and as a result important climate change considerations are overlooked during project planning and design. Thus, implementation of mitigation measures and monitoring programs are not in place to counter the hazards posed by extreme events caused by climate change.

10. Thus, the urban development sector faces numerous risks associated with financial management, procurement, and corruption. Many of them are major risks that need to be mitigated and/or managed for the success of ADB's grants, loans and technical assistance for development interventions in the urban development sector of Nepal. The summary of priority risks and mitigation/management measures that can be taken by ADB are depicted below:

S.N.	Major Risks	ADB Actions for Mitigation/Management
(A) Public Financial Management		
01.	The institutional capacity of municipalities to manage their finance, in terms of professional human resource and accounting system, is	Technical assistance for: i) institutional capacity building of municipalities to upgrade existing financial management systems, develop

	low; and there is ineffective internal controls, audit, monitoring and evaluation systems along with high dependence on government grants and Local Development Fee.	strategic business plans, and enhance tax base assessments; ii) strengthening internal audit and monitoring and evaluation systems; and iii) preparation of phase out plan of local development fee , with alternative source of revenue, in conjunction with MuAN and MLD and in consultation with all municipalities.
02.	Low commitment to address auditor's comments and suggestions including regularization, realization and settlement of unsettled accounts.	Advocate that MC & PM applied for government grants ensure the incorporation of these issues.
03.	Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users' groups.	Develop monitoring mechanism in ADB projects to ensure that disbursements are made on time by the TDF and other responsible agencies. Establish quarterly and/or as and when necessary interaction amidst user groups, civil society and representatives of political parties in ADB projects. Support capacity development of leaders and office bearers of user groups.
(B) Procurement		
01.	Procurement is not integrated with financial management and there is absence of safeguards to ensure budget adequacy, Procurement Management and Information System (PMIS) and quality control and performance evaluation for procurement works: Eg. Absence of performance audit	Technical assistance to: i) enable municipalities to develop and implement a PMIS, which is integrated with municipalities' management information system to coordinate financial management, budgeting and procurement; and train relevant officials in quality control and performance evaluation for procurement Ensure that performance audit is a precondition for ADB projects in municipalities
02.	Bribes and corruption are accepted and taken for granted by the society	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns
03	Collusion is rampant and threats, intimidation, and extortions are common practices	Lobby and advocate for bidding in multiple places (two or more) and introduction of e-bidding system. Support FCAN to familiarize contractors on e-bidding and to develop simple instruction manual
04	Procurement plans (PP) are not prepared for use in budget formulation and procurement is not guided by specific procurement manuals.	Provide technical assistance to develop capacity of municipalities to prepare PP and manuals and advocate to ensure that PP is part of MC & PM.
(C) Corruption		
01.	Executing and implementing agencies do not have an effective anti-corruption strategy or action plan.	Provide technical support GoN for the preparation of an anti-corruption strategy and action plan for ministries/line agencies and local bodies
02.	CIAA presence at the district level is limited to	Lobby and support the establishment of CIAA

	deputation of legal officer in some District Administration Offices. No institutional presence at the local level.	offices at the regional level Lobby and support for permanent staff at the CIAA
03.	Culture of reporting corruption cases and complaining against irregularities by the civil society is low with the tendency of accepting petty corruption as a mean to get one's work done engrained in the people's mindset and) law enforcement agencies are perceived to be corrupt	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns
(D) Climate Change		
01.	Urban authorities, project proponents and EIA administrators lack the capacity and critical guidance on how to assess both climate change mitigation and adaptation issues and thus climate change considerations are overlooked in project planning; implementation of effects mitigation and monitoring programs; and contingency planning.	Help devise and support massive information campaign to: i) disseminate information on actual climate changes and future trends ii) highlight and articulate climate-risk management priorities and the role of communities, civil society and NGOs in managing climate change risks at the local level Support sectoral policies, strategies, and programs formulation to address the consequences of climate change and climate variability to economic development need and strengthen inter-agency and inter-sector collaboration

1.0 INTRODUCTION

1.1 Introduction

11. The Asian Development Bank (ADB), in consultation with the Government of Nepal (GoN) and other stakeholders, is preparing a new Country Partnership Strategy (CPS) for Nepal. The CPS is informed by a number of pre-CPS diagnostic studies, including an assessment of governance,¹ institutional, and corruption risks for sectors where ADB is active. This document, which assesses risks related to the urban development sector and formulates a mitigation management plan in alignment with ADB's Guidelines for Implementing the Governance and Anticorruption Action Plan II (GACAP II), is part of a series of background assessments and diagnostics commissioned by the ADB. Further, this document also delves into climate change as a cross cutting issue.

1.2 Objective

12. The objective of this document is to assess the public financial management (PFM), procurement, and corruption risks in the urban development sector, and prepare the necessary risk mitigation plan in line with the requirements, approach, and formats in the Implementation Guidelines for GACAP II.

1.3 Methodology

13. Literature review, web search and updating: Recent publications and diagnostics for the sector, relevant to the assessment, were identified and obtained to research whether the risks identified remain current, or have been successfully remedied.

14. Primary research: This was used as the main source of evidence for the risk assessment (RA) to assemble reliable evidence on the PFM, procurement, and corruption risks. It mainly comprised interviews and consultations with officials in government ministries and agencies, donors, municipalities and relevant projects. Interviews and consultations involved 85 persons from 34 organizations in six districts and two interactive sessions with representatives of donor organizations in the Nepal Resident Mission (NRM) of the ADB. (The list of persons interacted is available in Annex - I.)

15. Identification of major risks and formulation of risk management plan: All current and planned mitigation and reform actions were mapped in discussions with the government and other agencies. Assessments also focused on identifying major risks using the approach² in the Guidelines for GACAP II. The major risks were then carried forward to the risk management plan (RMP).

¹ ADB's Governance: Sound Development Management, 1995 defined governance as "...the manner in which power is exercised in the management of a country's economic and social resources for development." It identified the basic elements of good governance as accountability, predictability, participation and transparency.

² Sector risk assessment was undertaken as part of the sector assessment, including an assessment of the PFM, procurement, and corruption risks. Risk assessment was undertaken in an open and transparent manner and with the relevant stakeholders and partners to encourage a shared understanding and consensus of the associated risks. Risks assessed as likely, relatively serious and unlikely to be mitigated over the CSP period were identified as major risks.

1.4 Acknowledgement

16. This document would not have been possible without the support and contributions from a large number of development partners and stakeholders. I would like to put on record my sincere gratitude to all the officials of government bodies/agencies, development agencies and other stakeholders who provided support and valuable inputs. My special appreciation and thanks goes out to the executive officers and staff of Kathmandu, Lalitpur, Bhaktapur, Biratnagar, Nepalgunj and Bidur municipalities for their support and information. My sincere appreciation also goes out to ADB officials in Manila and the Nepal Resident Mission for their precious insights and suggestions during the course of this assessment.

2.0 CONTEXT

17. Nepal, which recently emerged from over a decade of civil war, is in a post conflict transitional period. The conflict severely impeded the development process of the country. Many physical infrastructures were destroyed and the country's local governance system was in disarray. Though the urban areas, under the jurisdiction of municipalities, were in a better position³ to undertake service delivery and maintain basic operations than rural areas, the conflict also impacted urban governance in the country in several ways. Rapid growth in urban population due to migration and displacement of rural people to urban areas and destruction of urban infrastructure⁴ challenged municipalities' capacities and ability to perform.

18. According to the Central Bureau of Statistics (CBS), GoN, National Planning Commission (NPC) Secretariat, the urban population comprised about 14 percent of the total population of Nepal in the year 2001 when the national census was last carried out. It had increased at the rate of more than 3.5 percent a year in the ten years period: 1991 - 2001. Two thirds of the total urban population was living in the 16 big municipalities and the remaining one third was living in 42 small municipalities with less than 50,000 population.⁵ Thereafter, the migration of rural people to urban areas appears to have increased. The CBS projected an annual growth rate of 5.57 percent in the subsequent five years period (2002 - 2006) with 4.32 million as the estimated urban population in the year 2006, which comprised 16.7 percent of the estimated total population. The share of the urban population is expected to reach nearly 20% of the total population in the year 2011 and is projected to go beyond 26% by the year 2021. However, even the CBS projection may not reflect the true urban population if the GoN decides to formally declare 41 small towns and their peripheral area as municipalities in line with the recommendation of the task force of experts constituted by the Ministry of Local Development (MLD) in the year 2002. The CBS population projection is presented in the table below.

Table - 1 Summary of Urban Population Projection, Nepal

Year	2001	2006	2011	2016	2021
Total population	23,151,422	25,886,736	28,584,974	31,327,340	34,172,140
Urban population	3,239,443	4,322,996	5,598,886	7,156,789	9,047,244
Urban population in %	13.99	16.70	19.59	22.85	26.48
Annual Growth rate in %		5.77	5.17	4.91	4.69

³ During the conflict, most of the rural areas were devoid of the State organs of governance. Majority of the VDC offices (about 80%) were destroyed by the rebels and were non-functional with the secretaries of these VDCs based in the district headquarters. In comparison, the municipalities, which had better security system in place, were under the control of the Government and remained functional throughout the conflict period.

⁴ Many municipal buildings at ward level and town halls as well as basic infrastructure, such as roads and bridges, which were damaged or destroyed during the conflict, needed reconstruction or refurbishment.

⁵ As cited in the Three Year Interim Plan (2008 - 10)

19. Though a vast majority of the Nepalese population lives in rural areas, the importance of the urban sector is increasingly acknowledged as urban areas, which provide for nearly five-fold per-capita contribution to the GDP in comparison to the rural population,⁶ expand in size and their environments deteriorate. The movement of people from rural to urban areas in search of better livelihood prospects and opportunities continues unabated and will significantly change demographic patterns affecting the socio-economic situation of the nation as a whole.

20. In line with Nepal's national policy of decentralization, the 58 municipalities are expected to take over the responsibilities for the management of the social and physical environment of their urban areas. However, a majority of the municipalities in Nepal have pre-dominant rural characteristics, with thin population density spread across large rural agriculture areas as many of them were created by lumping together a number of Village Development Committees (VDCs) within a new municipal administration. They are characterized by poor governance,⁷ inadequate basic infrastructure and low internal revenue generation making them largely dependant on government grants.

21. Hopes for better basic services, democratic participation and improved governance was raised when a peace and democratization process, which began in 2006, was successful in holding the elections for a constituent assembly in April 2008. Nepal now faces the challenge of reconciling rapid urbanization with the provision of socially and economically acceptable living conditions for its people, curbing rampant corruption and improving financial management and overall governance.

2.1 Overview of national institutions

22. At the central level, the responsibilities for urban sector development is scattered falling under the jurisdiction of a number of ministries and state agencies with the MLD, the Ministry of Physical Planning and Works (MPPW), and the National Planning Commission (NPC) being the key agencies. The NPC is the apex planning body and in a position to provide strategic thrust for urban development. The MLD, the link agency between the GoN and local bodies, is responsible for overseeing local governance, development and decentralization. The MPPW is responsible for physical planning, urban development and infrastructure works. In addition to these three agencies, other relevant institutions include: (i) the Local Bodies Fiscal Commission (LBFC), which was created in 2002 to play a central role in intergovernmental fiscal transfers related to local bodies, and (ii) the Municipalities Association of Nepal (MuAN), which was formed in 1995 as an apex umbrella body of the 58 municipalities to play an advocacy role to influence GoN policies, promote international relations, and provide technical advice and counseling to member municipalities.

2.2 Constraints

23. The growth of the urban sector and its implications, have not been understood well and adequately addressed. The government's development policies, priorities and budgets are still oriented towards the rural sector despite national economic growth being largely dependent on the growth of the urban sector. The role of the urban sector

⁶ According to available statistics in the Local Bodies Fiscal Commission, the average per capita income of municipalities over the three years period (2004/05 to 2006/07) was 4.72 times more than the per capita income of VDCs.

⁷ At the moment, municipalities' functions lack transparency, have poor downward accountability owing to absence of legitimate peoples' representatives since 2002, and is hampered by frequent changes of the executive officers and allegiance of staff along political lines.

and its linkage to drive rural growth has not been seriously examined and given priority. Measures to mobilize urban capital and resource potentialities for the benefit of the rural sector through redistribution of resources generated in the urban centers are inadequate and are greatly undermined and misunderstood by policy makers.

24. Owing to insufficient financial resources, lack of qualified human resources, and low institutional capacity, urban authorities are unable to keep pace with the growing demand for services with commensurate infrastructural facilities and good governance. Municipalities are characterized by inadequate drinking water supply, sanitation, transportation and roads, and health facilities which are further aggravated by the poor state of existing facilities. Serious environmental issues, including unacceptable level of vehicular pollution, haphazard disposal of solid and human waste, and illegal dumping of industrial waste into rivers and streams, are emerging due to uncontrolled urban development. Increasing level of migration has also resulted in widespread growth of informal settlements of squatters and slum areas, which are devoid of basic facilities. The resource gap covering the housing and urban development sector for the Three Year Interim Plan (TYIP) period (fiscal year 2007/08 to 2009/10) is estimated to be 3,305.59 million rupees. In order to fulfill this resource gap, there is a need to seek increased level of support from the donors and development partners. The resource gap is presented in the table below.

Table - 2 Resource Gap: Housing and Urban Development s in the TYIP Period (In Rs. '000)

Fiscal year	Available Budget	Budget Required	Resource Gap
2007/08	814,020	1,463,540	649,520
2008/09	895,422	2,268,230	1,372,808
2009/10	984,964	2,268,230	1,283,266
Total	2,694,406	6,000,000	3,305,594

Source: Thematic Paper, Infrastructure (Roads, Water Supply, Housing and Urban development), Mr. Purna Kadariya, Secretary, Ministry of Physical Planning and Works Kathmandu, Nepal, February 1, 2008

25. Many municipalities are unable to integrate and develop large tracts of rural areas within their jurisdictions,⁸ which lack basic infrastructure, into the urban mainstream as they do not have the necessary financial and institutional resources. Urban governance⁹ is further complicated by regional imbalance and large number of diverse stakeholders based on different ethnicities, castes, and religions.

26. The municipalities' direct accountability to the people has been questioned on account of continued absence of elected local representatives since 2002. Governance in municipalities is also hampered by frequent changes in the executive officers who are appointed by the GoN.¹⁰ Urban development is also hindered by the lack of coordination within, and among relevant line agencies, donor agencies, and municipalities.

27. Besides, the GoN has also acknowledged many constraints in local bodies. In this regard, the major problems in local bodies highlighted by the TYIP are presented in the box below.

⁸ As explained earlier, many municipalities were established by lumping together a number of VDCs with thin population density spread across large rural agriculture areas.

⁹ Using the definition in ADB's Governance: Sound Development Management, 1995 urban governance can be understood as the manner in which power is exercised in the management of municipalities' economic and social resources for development.

¹⁰ Executive Officers of local bodies are usually changed when a Minister from a different political party takes charge of the Ministry of Local Development.

Box - 1: Problems Related to Local Bodies

- Low institutional capacity and lack of capacity enhancement of human resource.
- Lack of timely reconstruction of infrastructure destroyed during the conflict.
- Lack of continued execution of provisions under the LSGA and confusion in its implementation owing to delays in the amendment of conflicting provisions in other acts and regulations.
- Lack of institutions to control corruption and compliance to fiscal discipline in local bodies
- Lack of timely and quality execution of development works owing to the absence of required technical support.
- Excessive work burden on the personnel deputed in local bodies.

2.3 Recent work to reform the sector

28. Until recent times, Nepal had no specific urban policy with successive Five-year Plans and sector specific policies guiding the urbanization process and enhancing urban-rural linkages. Realizing the need for a separate policy, the GoN formulated the National Urban Policy, 2007, which is the guiding document for urban development in Nepal. Also, the Vision Paper, 2007: New Physical Infrastructure of Nepal, which was developed by MPPW, envisages guiding urban development through industrialization and infrastructure development. The Department of Urban Development and Building Construction (DUDBC) has helped Kathmandu Metropolitan City (KMC) to prepare Integrated Action Plan (IAP)¹¹ for all wards. At this moment, the DUDBC has prepared IAPs for 30 municipalities.

29. The GoN has finalized the National Urban Water Supply and Sanitation Policy, after receiving suggestions and comments on the third draft policy from all interested individuals and organizations. The policy, which is the government's response to the severe lack of access to water supply and sanitation services in Nepal's urban areas, is awaiting the approval from the Council of Ministers.¹² The Three Year Interim Plan (TYIP), (2008 - 2010) emphasizes the need to maintain regional balance in urban development. It gives priority to: i) the improvement of urban environment, ii) strengthening the capacity of municipalities, and iii) preparing a basis for planned development of urban settlements.¹³

30. The National Building Code, 2005, which specifies safety standards for building construction, and the Local Infrastructure Development Policy, 2004, which gives emphasis to decentralization of local infrastructure management, are other important reforms in the urban sector. The Road Board Nepal (RBN) was established by the GoN in 2002 to address road maintenance issues. The World Bank (WB), Swiss Agency for Development and Cooperation (SDC) and other development partners are assisting the Government for needed institutional reform and corporate strengthening of RBN to ensure proper maintenance of roads. The GoN upgraded the Municipality Management Section to Municipality Management Division in the MLD in 2001. With the establishment of this Division, which has three sections (Municipality Management, Municipality

¹¹ IAP, a simple form of urban planning, schedules investments in construction and land improvement actions, relates them to physical planning policies, involves stakeholders in the process, and concerns itself with how municipalities will finance its share of the costs. It comprises: i) Package of projects, with preliminary designs and cost estimates; ii) Multi-sector investment plan for 5 years, with a detailed municipal budget for the first year; and iii) Physical and environmental development plan: policies, maps and regulations.

¹² This was cited by the official in the DWSS.

¹³ Source: <http://www.npc.gov.np/uploads/publications/20081228111902.pdf>, Three Years Interim Plan's Synopsis, 28 December, 2008 — Publication

Planning, and Environmental Management), the MLD expanded its institutional set-up for overseeing municipalities' functions and gave more emphasis to: i) institutional development and fiscal and administrative strengthening of municipalities; ii) resource mobilization and coordination; iii) support on infrastructure development and service delivery; and iv) policy formulation, coordination, monitoring and evaluation of environment and sustainable development.

3.0 DESCRIPTION OF THE SECTOR

3.1 Sector history and focus

31. In Nepal, the history of urban planning began during the period of the Third National Plan (1967-71) when the Government realized the need for master plans for the cities in Kathmandu Valley and other major towns of the country. In the Fourth Five-year Plan (1972-77), the Town Plan Implementation Act, 1973 was introduced to regulate the growth of cities and towns. In the Fifth Five-year Plan (1977-82), physical planning of the urban centers received policy guidelines and emphasis. With the country divided into 4 development regions, a comprehensive physical development plan, including land use components, was introduced. During the Sixth Five-year Plan (1982-87) emphasis was given to the land use development plans of the five regional headquarters.

32. With the inclusion of a separate urbanization policy, the Seventh Five-year Plan (1987-92) formally initiated urbanization in Nepal. Important urban institutional arrangements, such as the former Ministry of Housing and Physical Planning, Nepal Water Supply Corporation, Urban Development Training Center, and Town Development Committees, were established during this period.

33. The Eighth Five-year Plan (1992 - 97), for the first time in Nepal, viewed the urban sector as a contributor to the national economy and not merely in terms of physical development. Planned development of urban areas by updating physical planning of all municipalities and supporting urban management through the capacity development of municipalities was emphasized. The National Plan of Action for Habitat II (to improve settlements and create healthy environment-friendly urban areas), the National Housing Policy, 1996, and the establishment of the Town Development Fund (TDF) (to provide grants and loans to municipalities) were some of the major reforms witnessed in this period.

34. Building on the National Plan of Action, the Ninth Five-year Plan (1997- 2002) focused on improving urban living conditions and productivity in support of overall development and poverty alleviation. The plan period was most significant as it ushered in comprehensive devolution of administration and financial authority and urban management functions to local governments through the enactment of the Local Self-Governance Act (LSGA) in 1999.

35. The Tenth Five-year Plan (2002 - 07) emphasized three sectoral programs: urban development, housing, and building construction. It aimed to plan and regulate uncontrolled urbanization through physical planning interventions and strengthening of social infrastructure for sustainable development of cities and towns. It envisaged doing this through the introduction of regulatory frameworks for planned urban development, providing sustainable infrastructure, establishing urban-rural linkages, promoting safe and affordable shelters, and using local resources and technology.

36. The TYIP (2008 - 10) acknowledges infrastructure development as one of the primary basis of organized urbanization. It states that infrastructure development programs that are carried out under various names, directives and guidelines will be

carried further under the conceptual framework of Sector Wide Approach (SWAp) by coordinating with donor agencies supporting the programs. Besides the planned programs of municipalities on the basis of their internal revenue generation, project loans, and donor funding support, the TYIP has targeted the completion of 240 physical infrastructure related development programs under a cost sharing arrangement from the Reserve Fund,¹⁴ improvement of basic minimum services of 53 municipalities, detailed study of sanitary landfill sites in 50 Municipalities, and construction of landfill sites.

3.2 Legal framework and institutional arrangements

37. A three tier governance structure, comprising the central government at the top of the hierarchy followed by District Development Committees (DDCs) in the middle, and municipalities and VDCs at the lowest tier, is currently prevalent in Nepal. The LSGA, enacted in May 1999 and followed by two sets of rules and by-laws (Local Bodies Financial Administration Regulations (LBFAR), 1999 and Local Self-Governance Regulations (LSGR), 1999), established municipalities as self governing autonomous urban local bodies with a central role in urban development. The LBFAR, 1999 has been replaced by the Local Bodies Financial Administration Regulations (LBFAR), 2007.

38. The Governance (Management and Operation) Act, 2008 spells out administrative and the responsibility of officials at different levels, including work procedures to be adopted in government administration. The Act mandates keeping a citizen charter, providing mobile services, conducting public hearings, managing grievances, setting up monitoring and evaluation committees and the submission of annual reports by government agencies.

39. At the present moment, there are 58 municipalities¹⁵ which are divided into a minimum of nine wards with the maximum depending on the population, geographical coverage, level of urban services, and income.¹⁶ All the mayors, deputy mayors, and ward members of the municipalities are elected by universal adult franchise. The elected members of municipalities and VDCs elect their respective *Ilaka*¹⁷ members and the chair and vice chair of the DDCs. All local bodies, including municipalities, have a council, which functions as a legislative body, to approve budget and programs.

40. The LSGA has mandated 10 major functions with 68 sub-functions to municipalities while another 13 functions are optionally available. Major municipal functions include fiscal administration, physical development, water resources, environment and sanitation, education, culture, construction and transportation, health services, social welfare, industries, and tourism. Municipalities are directly involved in the planning and implementation of projects at the lowest ward levels. However, coordination and planning between municipalities and DDCs is nominal despite the provisions made in the LSGA. Municipalities, which enjoy comparatively better financial

¹⁴ The Reserve Fund is the fund, created by GoN, with the surplus balance remaining from the Local Development Fee after it has been distributed to municipalities. The Fund is supervised by the MLD. It is provided to municipalities, who don't have adequate fund, on demand basis to partially finance (50 to 90 percent of the project cost) priority projects that have been included in their annual plan. In the case of Municipalities with a strong financial base, the Reserve Fund supports municipalities on the basis of equal sharing of the proposed project cost (50%) while in the case of small municipalities, with weak financial base, the financing from the Fund can go up to 90 percent of the project cost. The distribution of the Reserve Fund, which supports comparatively larger projects, is governed by the Reserve Fund Implementation Procedures.

¹⁵ These comprise 1 metropolitan city (Kathmandu), 4 sub-metropolitan cities (Biratnagar, Lalitpur, Birgunj and Pokhara) and 53 municipalities.

¹⁶ Kathmandu metropolitan city, with 35 wards, has the largest number of wards among municipalities in Nepal.

¹⁷ Areas that cover a cluster of VDCs and municipalities.

and administrative autonomy in comparison to DDCs and VDCs, are less likely to coordinate their activities with DDCs and VDCs.¹⁸

3.3 Policies and strategies

41. The National Urban Policy, 2007, guides urban sector development in Nepal. The TYIP (2008 - 10) cites that the major objective of the GoN's local development program is to support poverty alleviation measures on the fundamental premise of inclusive development by involving local inhabitants, mobilizing local resources, using local skills and technology, and creating employment and income generating opportunities. It further states that the GoN strategies focus on: (a) demand driven, targeted and community focused programs to increase the access of marginalized and backward people and geographical areas; (b) promoting good governance by strengthening the local self-governance system, enhancing local bodies' capacity to mobilize and effectively use internal and external resources, improving overall institutional capacity of local bodies, devolving authority on a sector wide scale and coordinating with local level stakeholders; and (c) creating employment opportunities at the local level and increasing the access of people to the facilities and services through the development of environment friendly infrastructure based on labor intensive technology and local resources in accordance with the Strategic Work Plan for Local Infrastructure.

42. The MLD intends to adopt the sector wide approach (SWAp) to manage local governance rather than having a series of projects with their own funding, management, implementation and reporting arrangements. The key features of the sector wide management, to be developed and introduced during the implementation of the Local Governance and Community Development Programme (LGCDP)¹⁹, are: i) provision of a single clear sector policy and strategic framework that links sector policies and the LGCDP including the expenditure plans for the sector, so that the allocation of resources reflects the priorities of the sector; ii) annual program and budget which specify the activities to be carried out under each strategic objective and by department, divisions and local bodies; and iii) reporting on activities and performance indicators against the plan, with common reporting and performance monitoring arrangements.²⁰

43. Municipalities function in accordance with the LSGA. The LSGA has mandated municipalities to raise revenue form through taxes and other non-tax sources. The LSGA has also made provisions for the disbursements of Government grants to municipalities. Besides, municipalities also receive, on an annual basis, the Local Development Fee (LDF), which was introduced by the GoN as an interim measure for the replacement of octroi. It is levied through the Finance Act, which is not a part of the municipal tax under the LSGA. The LDF is collected at customs offices of the central government at the rate of 1.5 percent of import value. LDF is distributed on the basis of the collection of octroi in fiscal year 1997/98 (year previous to abolition of octroi). The LDF amount was raised by 15% in the fiscal year 1999/2000.

44. Tax revenue is the primary source of revenue in municipalities. In Nepal, the central government dictates tax policies applicable to the central as well as to the local

¹⁸ The Executive Officer and officials in the municipalities, that the study team visited, reported low level of coordination between their municipalities and the DDC/VDCs.

¹⁹ A major program of GoN supported by many development partners of Nepal, including the ADB, covering all 75 districts, including 58 municipalities and 3,915 VDCs. The program comprises 5 components: i) Empowerment of citizens and communities for active engagement with local governments and strengthening downward accountability; ii) Local bodies enriched with block grants for community led development; iii) Capacity development of local governments for effective service delivery; iv) Policy support for decentralized local governance; and v) Gender and social inclusion.

²⁰ The paragraph has been adapted form Local Governance and Community Development Programme (LGCDP), Programme Document, 11 July, 2008, GoN, MLD.

governments, which have very little say in this regard. The LSGA and LBFAR define and clarify the revenue assignments to local governments. Municipalities are entitled to levy house and land tax, land revenue/land tax, vehicle tax, advertisement tax, business enterprise tax, service charge, various types of fees, and rental tax on land and building.

45. GoN grants, conditional as well as unconditional, comprise a major source of revenue to Municipalities, especially in the case of smaller municipalities who are unable to raise large sum of fund from their own revenue source. At the outset, the estimate of Government grants to be allotted to local bodies is prepared by MLD as part of its overall budget in line with the guidelines and policies issued by the Ministry of Finance (MoF) and the NPC. This is forwarded to the NPC and the MoF. The MoF, in consultation with MLD and NPC, prepares the budget for the MLD containing all estimated expenditures. Though all grants to local bodies form part of the MLD budget, the MoF directly transfers grants to municipalities on the recommendation of the MLD.

46. Right from the outset, the GoN has been allocating unconditional block grants to Municipalities. A set formula based criterion²¹ is applied to determine the volume of block grants provided to each municipality. These unconditional grants have been used in undertaking development programs related to infrastructure development, institutional development, and local capacity building. Besides, this grant amount has also been used as a matching fund by the GoN to fulfill the requirement stipulated in donor funded development projects. The Municipality Partnership Development Fund was instituted for this purpose in 30 municipalities.

47. The MLD, under the umbrella of the "Unconditional Development Grant", disburses eight different types of grants²² to municipalities. During the fiscal year 2007/08, a total amount of Rs. 311.0 million was disbursed. The development grant, earmarked for development activities, is provided by MLD to the small municipalities with annual internal revenue generation of less than 10 million rupees. Larger municipalities fund capital investments through own revenue sources, which also comprise the Local Development Fee (LDF). This policy has encouraged many smaller municipalities, which generate insufficient own revenue, to rely more on development grants than mobilizing internal resources. During the fiscal year 2007/08, altogether 47 municipalities²³ received a total amount of 216.50 million rupees under this grant.²⁴

48. In recent times, the Reserve Fund, created through local development tax, has been used for blacktopping of roads, construction of gravel roads, sewerages, conference halls, weekly markets sheds, slaughterhouses, and waste management facilities in the municipalities.²⁵ The conditions applicable for the Reserve Fund are presented in the table below.

Box – 2: Conditions Applicable to the Reserve Fund

- Each municipality can apply for two projects at a time not exceeding five projects in a fiscal year. Application for additional projects can be made only after the completion of these two

²¹ Municipalities' development index (40% weightage), population (25% weightage), cost index (25% weightage) and area coverage (10% weightage) are the criteria used to determine the volume of block grants.

²² These comprise: i) Administrative Grant; ii) Development Grant; iii) Matching Grant; iv) Resource Mobilization Grant; v) Social Mobilization Grant; vi) Grant for Landfill Sites; vii) Fire Fighting Vehicle Grant; and viii) Guest House Grant.

²³ Eleven municipalities (Mechinagar, Biratnagar, Kathmandu, Lalitpur, Dhulikel, Banepa, Gaur, Birganj, Butwal, Sidharthanagar and Nepalganj) are not eligible for this grant.

²⁴ Municipal Finance Systems in Nepal: Status Quo of Revenues, Expenditures and Transfers, June 2008, GTZ/UDLE.

²⁵ As cited by the Three-year Interim Plan (2008 - 10).

projects.

- Application should be made for projects mentioned in the Reserve Fund guideline.
- The total cost of the project should not exceed five million rupees. In case of projects to be jointly taken up by two or more municipalities additional five million rupees per municipality can be provided.

49. One of the major programs, envisaged by the TYIP (2008 - 10), for local governance is the Local Bodies Grant and Management Program, which includes disbursement, management and monitoring of grants to local bodies (DDCs, Municipalities and VDCs). The activities under this program primarily comprise: i) development of scientific parameters and indicators for monitoring and updating along with institutionalization of the monitoring and evaluation system; ii) central level record keeping of progress and achievement; iii) preparation of work plans,/manuals and orientation workshops and training programs; and iv) disbursements of funds to municipalities from the block development revenue collection based on a pre-determined formula.

50. As per Regulation 273 (Gha) of the LSGR, there is a provision to determine the volume of government grant²⁶ to local bodies in line with the recommendation of the LBFC and the evaluation of local bodies' performance based on rating against predetermined minimum conditions and performance measures criteria. Following the acknowledgement of this provision by the budget speech of GoN for the fiscal year 2006/07, the GoN accepted this principle for determining the volume of government grant to local bodies.

51. Further, the GoN, under the LGCDP, will provide "Expanded Block Grant (EBG)" to all municipalities from the fiscal year 2009/10. The smaller (less financially endowed) municipalities will receive capital grants from the LGCDP in line with financing procedures developed by the MLD and the sub-activities will include: i) definition of the municipal grant system for block formula grant (application and size); ii) elaborate block grant guidelines; iii) elaborate municipal block grant formula; iv) refinement and implementation of Minimum Conditions and Performance Measures (MCPM) system; and v) disbursements of block grants. Likewise, metropolitan and sub-metropolitan municipalities will receive reforms support based on their overall system of finance (such as: own source revenues, taxes, user fees, borrowing etc.) and sub activities will include: i) review and recommendation of the funding system for metropolitan and sub-metropolitan municipalities; and ii) implementation of recommendations for the overall system of funding including systems for improved performance incentives.²⁷

52. As a preparatory work for the implementation of this program in municipalities, a collaborative effort by the MLD, LBFC and GTZ/UDLE piloted the use of MCPM²⁸ in 16 municipalities in the fiscal year 2007/08, so as to use the MCPM as a basis to determine the volume of EBG to each municipality as well as to top the grant amount by an additional fund in the form of reward to municipalities which perform well. At this moment, the "MCPM Guidelines for Municipalities, 2009" has been finalized and will be published in the near future.

²⁶ Determining government grant could be in the form of decreasing or increasing the annual grant or topping annual grant with a reward to local bodies that perform well.

²⁷ Source: Local Governance and Community Development Programme (LGCDP), Programme Document, 11 July, 2008, GoN, MLD.

²⁸ The LSGR (Regulation 273) provides for the use of the MCPM for the purpose of determining the volume Government grant and rewarding local bodies who perform well.

3.4 Relationship between national government and municipalities

53. In Nepal, the sectoral ministry, the MPPW, in conjunction with the Department of Urban Development and Building Construction (DUDBC), guides and directs urban planning initiatives. However, the LSGA empowers municipalities to prepare their own periodic plans²⁹ and programs. The MLD strongly advocates periodic plans of municipalities to guide urban infrastructure development. However, only ten municipalities have, to date, developed periodic plans, which are yet to be approved by their respective council. The MLD, as the supervisory ministry, is vested with the right to issue directives and guidelines under the decentralization framework while the MPPW, on the other hand, does not have this right. Consequently, this type of policy divide and ambiguity sometimes places municipalities in difficult situations. The MPPW has developed Town Development Committees (TDCs) in all municipalities in Nepal mandated to plan development works within their own geographical area. The TDCs submit project proposals to the MPPW for funding. The transfer system and criteria for project selection are not fully transparent and uncoordinated with the municipalities.

54. Municipality revenue comprises a combination of taxes and fees levied by the municipality locally; intergovernmental transfers from DDCs, the MLD, the DUBDC and the RBN; and funds from donors and the TDF. In the fiscal year 2008/09, about 4 percent of the national budget is allocated to local bodies (DDCs, VDCs and municipalities). Out of this 4 percent allocated to local bodies, municipalities' share was less than 0.14 percent, which actually works out to less than 3.50 percent of the total budget allocated for all local bodies.³⁰ This shows that financially, municipalities are pretty much left on their own in the task of mobilizing resources. Similarly, the TYIP (2008 - 2010) has allocated 51,800 million rupees for local bodies; out of which 5,840 million rupees (11.27%) have been allocated for municipalities. Improvement in the basic infrastructure of municipalities and organization and strengthening of new municipalities, which account for 51.37% and 23.75% of the allocated fund for municipalities respectively, are the major areas emphasized by the TYIP.

3.5 Municipalities' fiscal record in budget implementation.

55. Governance issues have been a major factor undermining the effectiveness of municipality spending. These are characterized by: (i) excessive involvement of political parties during selection and implementation of projects; and (ii) increasing level of corruption.³¹ Though the municipality officials, in the districts visited, stressed that need-based bottom up approach is followed through consultation with community leaders in the presence of local political leaders at the ward level during the program planning stage, in reality, it is the representatives of political parties, who constitute an all party advisory body, that advise and support the Executive Officer,³² who is currently vested with the authority of the municipality council. Frequent transfers of Executive Officers are common as this normally happens when a new minister takes charge at MLD.³³

²⁹ Periodical Plan is a guiding development plan document, in principal aligned to the five year plan of the GoN, for local bodies for a fixed period - usually five years. The Plan presents: i) the development vision and overall goal; ii) development objectives; iii) development principal and priorities; iv) sectoral goals, results, indicators and strategies; v) major programs; and vi) priority projects targeting specific locations or groups. It is supported by: i) an in-depth situation analysis of development opportunities and challenges; ii) strategies for generating resources; iii) budget allocations; and implementing mechanisms with responsibility matrix, institutional set-up and monitoring and implementation schemes.

³⁰ Estimates of Expenditure for Fiscal Year 2008/09 (Red Book), Ministry of Finance, GoN

³¹ This was the opinion of key stakeholders at the national and district level.

³² The executive officer is deputed by the MLD.

³³ Among the municipalities visited, Patan, Bidur and Bhaktapur had 3 executive officers in the past one year while Biratnagar, Kathmandu, and Nepalganj had 2 each.

56. In most of the municipalities budgets are not in line with actual revenue generation. Programs are selected to appease key stakeholders despite revenue constraints that fall short of budgetary requirements. This is validated by the table below which shows that municipalities were only able to generate just 64.63 percent of the projected revenue in the fiscal year 2006/07. Thus, ultimately, projects that have the support of influential political leaders and pressure groups can gain precedence over other projects that are higher up in the priority ranking.³⁴

Table - 3 Municipality Revenue Composition (in Rs. '000)

Major Revenue Heads	F/Y 2006/07 (Projected)	F/Y 2006/07 (Actual)	Budget Achievement %
Own Source Revenue	2,309,547	1,946,352	84.27
Local development fee	991,967	986,376	99.44
House/land & property tax	336,505	266,615	79.23
Other tax revenue	193,750	118,554	61.19
Fees & fines	481,781	444,625	92.29
Property rental	129,222	86,293	66.78
Other revenue	176,326	43,889	24.89
Miscellaneous Income	250,239	259,085	103.53
Grants	2,243,127	1,099,368	49.01
GoN/Administrative	53,368	53,956	101.10
GoN/Development	826,788	643,433	77.82
DDC & other agencies	1,217,749	378,850	31.11
Town Development Fund (TDF)	145,222	23,129	15.93
Loans (TDF & others)	318,173	47,778	15.02
Balance Forward	445,379	245,119	55.04
Total Revenue	5,566,965	3,597,702	64.63

Source: Draft Annual Report on Analytical Review of Municipal Revenue and Expenditure for Fiscal Year 2006/07, LBFC

57. A similar situation also prevails in the expenditure front. Municipalities fell far behind when actual expenditures on major heads are compared to the projected ones. This is validated by the table below which shows that, in the fiscal year 2006/07, the overall actual expenditure was short by 44.58 percent in comparison to the projected expenditure. The situation was even worse in the case of capital expenditure, used for financing infrastructure related projects, which fell short by some 56.55 percent when compared to the estimated budget amount.

Table - 4 Municipality Expenditure Compositions (in Rs. '000)

Major Expenditure Heads	F/Y 2006/07 (Projected)	F/Y 2006/07 (Actual)	Budget Variance in %
Current/Administrative Expenditure	964,144	845,758	12.28
Debt Service	78,351	68,719	12.29
Social Program	804,367	576,867	28.28
Expenditure on Fixed Capital	81,006	22,340	72.42
Capital Expenditure	3,721,715	1,617,245	56.55
Total Expenditure	5,649,584	3,130,928	44.58

Source: Draft Annual Report on Analytical Review of Municipal Revenue and Expenditure for Fiscal Year 2006/07, LBFC

³⁴ This was also cited by municipal staff, excluding executive officers, in Biratnagar, Lalitpur, Bidur and Nepalgunj.

58. Owing to weak financial management systems, most municipalities are unable to link capital budgets to a multi-year perspective of project financing in alignment with periodic plans. The budget is also not used as a monitoring tool for financial performance. Likewise, municipalities do not seem to have developed financial plans in line with their overall development goal.³⁵

3.6 Recent work to assess and reform PFM, procurement, and corruption in local bodies

59. Though assessment of PFM, procurement, and corruption at the national level has been done with the support of bilateral and multilateral development agencies, there is a shortage of recent work to assess and reform PFM, procurement, and corruption specifically focusing on the urban development sector. The German Technical Cooperation (GTZ) - Urban Development through Local Efforts (UDLE) Program report: "Municipal Financial System: Status Quo of Revenues, Expenditure and Transfers" and Annual Reports of the Local Bodies Fiscal Commission are few exceptions. For the first time in Nepal, the Public Expenditure and Financial Accountability (PEFA) unit in the MLD, with the help of a private consulting firm, is about to complete a PEFA on a sample of local bodies comprising 5 DDCs, 3 municipalities and 10 VDCs. A Review of Financial Management and Accountability at the local level, focusing on the DDCs, was performed by the GoN with the support from the WB in September 2006. Though the findings of the report is primarily based on DDCs, one of the findings pertaining to lack of predictability of government grants is also applicable in the case of municipalities. The report states that the lack of predictability does not allow local bodies to engage in multi-year financial planning. It further mentions that the Central Government grants are determined on an ad hoc basis in the framework of the national budget formulation process. A ceiling is notified at the beginning of the planning/budgeting process but the final amount is known only after the budget is approved. Thus, it is not surprising to note that municipalities have to forego some planned development projects as they often overestimate the projected development grant to be received from the government.

60. The Parliament approved the Public Procurement Act (PPA), 2007 on January 2007 and the GoN issued the Public Procurement Regulations (PPR) on August 2007 and established a new framework for regulating, managing, executing, and overseeing procurement in Nepal. Enforcement of the Act is expected to maintain transparency in public procurement as the Act has incorporated many disclosure provisions including the right to know the results of the awards. The Act also aims at harmonizing the country's procurement procedures with international standards so that the donor community's confidence in government's procurement procedures can be enhanced. The Act is expected to bring uniformity in laws to be followed by donor community as they currently follow their own procedures when it comes to inviting tenders and awarding contracts for development projects. The Public Procurement Monitoring Office, headed by a full time secretary, has recently been established in the Office of the Prime Minister and Council of Ministers. The Local Bodies Financial Administration Regulations (LBFAR) were also introduced in 2007 to strengthen the financial authority of local bodies, improve transparency through the provision of community procurement and public audit, and enhance the accountability of local bodies.

61. Nepal signed the United Nations Anti-Corruption Treaty in 2003 that was ratified by the government in 2004, with a commitment of introducing a relevant Act in order to fight corruption. The National Vigilance Center (NVC) was established in August 2002, as per Chapter 4 of the Corruption Control Act, 2002, under the direct supervision and

³⁵ This was evident in all the 6 municipalities visited.

control of the Office of the Prime Minister and the Council of Ministers. The NVC focuses on corruption prevention, monitoring, and assessment of service delivery effectiveness.

62. The Corruption Control Act, 2002 and the Commission for the Investigation of Abuse of Authority (CIAA) Act 2002 deal with corruption issues in Nepal. Curbing corruption has featured prominently in the various political agreements since 2006, including the 2006 Interim Constitution.³⁶ Besides the new Procurement Act, new legislations with anticorruption provisions have been enacted in recent years—the Promoting Market Competition Act, 2006; Right to Information Act, 2007; Special Court Act, 2002 (amended in 2007); and Anti-Money Laundering Act, 2008. Nonetheless, corruption remains a key governance challenge as legislative compliance is weak and anticorruption organizations lack consistency in terms of jurisdiction and suffer from low capacity.

4.0 FINDINGS

4.1 Country Systems

4.1.1 Financial management and controls

63. The LSGA allows municipalities to choose between two options that allow them to maintain accounts under a corporate commercial accounting system or a public government accounting system. Accounts are audited by auditors who are registered under the Office of the Auditor General. Mobilization of financial resources by municipalities is hampered by lack of a sound financial management system and innovative approaches to develop institutional capacity to manage their financial affairs. Systems on how to complement development plans with financial plans, assess potential resources, assess and collect tax, and carry out accounting and auditing exercises are weak and need major improvement.³⁷

64. Municipalities have a separate revenue section to perform revenue administration functions. This section also facilitates the valuation committee to undertake valuation of properties for levying taxes. Grants and loans account for a significant portion of the total revenue of municipalities. Though collected and distributed from the central level, the Local Development Fee (LDF), which in principle is categorized as a local revenue source as it compensates for the octroi tax of goods entering in and out of the municipalities, accounted for a significant portion of the municipalities own revenue (50.68%) and tax revenue (71.02%) in F/Y 2006/07. However, municipalities can lose this major source of revenue with the entry of Nepal into the WTO as the import tax, which is the source of LDF funds, must be discontinued from 01 January, 2011. This will adversely affect municipalities' cash flows and curtail their expenditure on infrastructure projects. The LDF is followed by the house, land, and integrated property tax which accounted for 19.70% of tax revenue of municipalities in F/Y 2006/07. The aggregated tax revenue of municipalities for fiscal years 2005/06 and 2006/07 is presented in the table below.

³⁶ The Interim Constitution of Nepal, 2007, Part 4: Responsibilities, Directives and Policies of the State - 33. Responsibilities of the State (J) mentions: "To adopt a policy of taking severe action and punish the individuals who earn unjust wealth through corruption by holding an office of profit." Further, Part 11 of the Constitution entitled "Commission for the Investigation of the Abuse of Authority" deals with provisions related to the CIAA. Likewise, the Comprehensive Peace Agreement concluded between GoN and the Communist Party of Nepal (Maoist) on November 21, 2006 under Section 3: Political - Economic - Social Transformation and Conflict Management; Sub-Section 3.11 states that: "Policies shall be adopted to take strict actions against those, who occupying governmental position of benefit, have amassed huge property through corruption."

³⁷ This was the opinion of the majority of stakeholders interviewed during the course of the assessment.

Table - 5 Tax Composition of Municipalities (aggregated) (in Rs. '000)

Particulars	FY 2005/06		FY 2006/07	
	Amount	Weight (%)	Amount	Weight (%)
Local Development Fee	986,640	74.19	986,376	71.02
Vehicle Tax	31,422	2.36	28,357	2.03
House, land tax and integrated property tax	229,140	17.23	266,615	19.70
Professional taxes	57,321	4.30	58,201	4.19
Other direct/indirect taxes (House rent, contract, local market, sales taxes)	21,471	1.61	30,076	2.56
Other taxes and arrears	4,154	0.31	2,019	0.50
Total Local (direct/indirect) taxes	1,330,148	100.00	1,371,544	100.00

Source: Draft Annual Report on Analytical Review of Municipal Revenue and Expenditure for Fiscal Year 2006/07, LBFC

65. One of the most important tax source prescribed by the LSGA is the property tax which was also called “an alternative to octroi”. In other terms, it was assumed that this tax would generate a bulk of municipal revenue for a majority of municipalities as it was in the case with octroi. However, the reality ‘on the ground’ is far different. Once again, limited concern to diversity factor has virtually made this property based taxes only benefiting smaller proportion of municipalities i.e. larger municipalities with high ratio of urban population. Out of the total 58, about 66 percent are small municipalities with very low level of tax base and average level of tax management skills.

66. Municipalities' revenue is usually overestimated to match budgets for capital and current expenditure. The tendency for an annual increment in revenue targets by a certain percentage without a systematic assessment of the portfolio is prevalent. However, in reality revenue generally falls short of planned targets thus adversely affecting expenditure outruns. In the fiscal year 2006/07, municipalities' actual revenue collection comprised 64.63% of the projected amount.³⁸ The financial statements (audited and provisional) of the municipalities visited for fiscal year 2007/08 also indicated a similar trend with actual revenue comprising just 51.23% of the projected amount. It appears that the municipalities' authorities were also unable to predict government grants accurately as the actual grant accounted for only 47.2% of the projected amount. The revenue composition of the six municipalities visited is presented in the table below.

Table - 6 Revenue Compositions of Municipalities Visited for F/Y2007/08

Income Source	Budget	Actual	Percentage
1. Own Source	1,655,033	1,104,037	66.71%
a) Own Source excluding LDF	1,243,397	692,401	55.69%
b) Local Development Fee (LDF)	411,636	411,636	100.00%
2. GoN Grant	509,905	241,805	47.42%
3. Donors, loans & others	680,624	111,858	16.43%
Total	2,845,562	1,457,700	51.23%

Source: Financial Statements of the Six Municipalities Visited³⁹

67. The stock of unsettled accounts has accumulated over the years and appears to be growing.⁴⁰ Long backlogs of accumulated unsettled accounts remain with less

³⁸ Source: Draft of Annual Report on Detail Revenue and Expenditure Breakdown, 2064, LBFC

³⁹ Visits were made to offices of Kathmandu, Lalitpur, Bhaktapur, Biratnagar, Nepalganj and Bidur municipalities.

possibilities of the current leadership taking necessary initiative to settle this. Likewise, the volume of accumulated unsettled account of the MPPW, the primary line agency responsible for urban infrastructure development, appears to have increased. This is validated by the fact the unsettled account which amounted to Rs. 1.675 billion at the end of fiscal year 2003/04 increased to Rs. 3.182 billion at the end of fiscal year 2006/07. The detail of unsettled account, under the MPPW during this period, is depicted in the table below.

Table - 7 Unsettled Accounts of MPPW (in Rs. '000)

Fiscal Year	Unsettled Amount	Settled in Fiscal Year	Unsettled for Fiscal Year
Up to F/Y 2060/61	2,272,948	597,636	1,675,312
F/Y 2061/62	258,039	58,210	199,829
F/Y 2062/63	1,036,515	456,707	579,808
F/Y 2063/64	726,911	0	726,911
Total accumulation	4,294,413	1,112,553	3,181,860

Source: Auditor General's Annual Report, 2007 (Part 3)

68. Budget heads have been classified in line with provisions made in the LSGA. Budgets are computed with inputs from the various sections of the municipality and are basically computed in a simple format, with budget heads being classified in line with provisions made in the LSGA. The budget does not provide comprehensive information pertaining to macro economic assumptions: least estimates of aggregate growth, inflation, deficit financing, and anticipated composition of debt stock and financial assets.⁴¹

69. Expenditure composition of Municipalities for the fiscal year 2006/07 fell short of the projected amount by 43.45%. This trend is also validated by the financial statements of the six municipalities visited which show that the total actual expenditure of these municipalities for the fiscal year was just 52.49% of the budgeted amount. The budgeted and actual expenditure composition of the six municipalities visited is presented in the table below.

Table - 8 Expenditure Compositions of Municipalities Visited for F/Y 2007/08 (in Rs. '000)

Expenditure Heads	Budget	Actual	Percentage
Current Expenditure	81,911	408,165	84.70%
Debt Service	95,330	58,771	61.65%
Social Program	237,305	111,574	47.02%
Capital Expenditure	2,031,016	891,633	43.90%
Others	0	23,543	-
Total	2,845,562	1,493,686	52.49%

Source: Financial Statements of the Six Municipalities Visited

70. Transparency in financial management varies among municipalities. In most municipalities, budgets are published on the municipal notice boards, while statements of accounts are not always made public. Information on key fiscal aspects such as documented annual budget, in-year budget execution reports, year-end financial statements, and external audit reports are not generally publicized by most municipalities.

⁴⁰ All the executive officers in the municipalities visited reported that accumulated unsettled accounts remain for a long period and it would be very difficult for them to settle them, in the absence of the Municipality Council, as they have remained unsettled for a long period of time. They expressed commitment to settle recent unsettled accounts.

⁴¹ None of the budget documents in the five municipalities visited had this information.

71. The use of participatory planning is not undertaken systematically by municipalities, as required by the LSGA (section 122). This is partly a consequence of limited downwards accountability and lack of capacity to comprehend the planning system which has been aggravated by the absence of local elected representatives since 2002. The capacity to plan and formulate budget varies according to municipal size, and qualifications of and the number of staff. Municipalities produce an annual budget, in compliance with the LSGA, and accounts are kept and updated regularly. Budgets seem to follow the required format in the LSGA (section 130) outlining the previous two years' budget and budget execution rate. The link between the annual budget and the annual plan is not clear. The budgets normally exceed the actual revenue collection of the municipalities. In many municipalities budgets are not passed on time. Three out of the six municipalities visited (Biratnagar, Lalitpur and Kathmandu) had not passed their budget for the current fiscal year and program selection was still going on while the budget of Bhaktapur municipality was passed recently by the Executive Officer.

72. Though municipalities are required to share their plans with the DDC for inclusion in the annual district plan, coordination and joint planning between DDCs and municipalities is limited. Normally, the municipal plans requesting DDC funding are forwarded to the DDCs while the plans covering implementation of projects through internal revenue are not shared. As a result, the annual district plans are not in a position to include the bulk of development activities being undertaken at the municipal level, limiting opportunities for joint and coordinated planning.

73. Multi year perspective in fiscal planning, expenditure and budgeting (preparation of multi-year fiscal forecast and functional allocations; scope and frequency and debt sustainability analysis (DSA); existence of sector strategies with multi-year costing of recurrent and investment expenditure; linkages between investment budget and forward estimates) were not practiced by the municipalities visited. Periodic plans are not used by municipalities as a management instrument. Only ten municipalities have produced periodic plans, and in most cases they have not been passed by the Council and are not used as a guiding document for their annual programs. Most of the municipalities have developed land use plans specifying designated areas for specific purposes. The updating of these plans and the enforcement is limited; as a result, most municipalities have a large number of people residing in informal settlements. Coordination and interaction between the municipalities and line agencies is weak. In particular, the role of the Ministry of Physical Planning and Works (MPPW) at municipal level is uncoordinated and runs in parallel to the municipal planning process.⁴²

74. The administrative head of the municipality, the executive officer, is deputed by the MLD, while the other staff members are hired locally. One of the biggest challenges for municipalities is updating staff capacity.⁴³ Accountability of the staff is more process-oriented rather than results-oriented. There is a lack of linkage between work performance and staff performance and periodical performance evaluation system is not practiced.⁴⁴ Thus, with the incentive to perform well missing, staff members play it safe by fulfilling procedural requirements rather than improving results. Municipalities have also been plagued by frequent changes of executive officers, which has limited management support for new initiatives and weakened downward accountability.

⁴² This was cited by most of the executive officers in the municipalities visited.

⁴³ All the Executive Officers interviewed cited this aspect as a major challenge.

⁴⁴ This was cited by the Executive Officers and most of the staff interviewed in the municipalities visited.

75. Internal audit units are not in place in most of the municipalities.⁴⁵ In most cases, the internal audit is not effective. A backlog of audits is quite common in municipalities. In the sub-metropolitan city of Biratnagar, the audit for F/Y 2003/04 and 2004/05 was done in fiscal year 2005/06 while the same for the F/Y 2005/06 was done at the end of 2006/07 and the auditor for F/Y 2006/07 and 2007/08 is on the final process of being appointed. Likewise, Bhaktapur municipality and Lalitpur sub-metropolitan city have not audited their accounts for the current fiscal year while Kathmandu metropolitan city's audit for the fiscal year 2004/05 is going on. The practice of periodical reconciliations varies among municipalities with reconciliations done either on a monthly, quarterly, semi annual, or annual basis.

76. In general, the Supervision and Monitoring Committee (LSGA section 139) is not effective at the municipal level. The implementation of the plans is monitored on an ad hoc basis by municipal staff.⁴⁶ The MLD, with the support of LBFC and GTZ/UDLE, is currently in the process of finalizing the Minimum Conditions (MC) and Performance Measures for municipalities in Nepal for monitoring purposes and determining grant allocations and eventually rewarding municipalities on the basis of their performances from the fiscal year 2009/10 onwards.

77. Municipalities generally rely on past trends and commitments made by donors to predict donor budgetary support. Donors' disbursements are timely but contingent on fulfillment of conditions and documentary and reporting arrangements.⁴⁷

78. At present, the activity of the private sector is increasing in development of managed settlements. A limited number of municipalities have opted for private sector participation or contracting out when delivering services to the citizens. The LSGA allows for private sector involvement in municipal service delivery. Most municipalities have poor solid waste management facilities, and lack clean slaughterhouses, markets, and public sanitation facilities.

4.1.2 Procurement

79. The main challenges related to the implementation of the Public Procurement Act (PPA)⁴⁸ are also applicable for line agencies and municipalities involved in the urban infrastructure sector. Municipalities follow the PPA but do not have a proper procurement plan and are not guided by specific procurement manuals. Donor-funded projects, with specific conditions for the incorporation of these elements, do have these provisions. Awareness of the basic elements of the Act and the improvements made in procurement procedures is low in municipalities. Procurement functions in municipalities are normally carried out by the official who is in charge of the store section.⁴⁹

80. In five of the six municipalities visited, procurement committees have been established in line with the PPA. The committees are functional for procurement that necessitates competitive bidding as per the provision of the Act. A separate procurement unit with trained procurement specialists is yet to be established in these municipalities. Though the post of procurement officer has been created, it remains vacant with the procurement function primarily assigned to the store section.⁵⁰

⁴⁵ Except for Kathmandu, all the other municipalities visited did not have a separate internal audit unit.

⁴⁶ As shared by MLD officials.

⁴⁷ As shared by officials in the municipalities visited.

⁴⁸ As identified by the GoN assessment of the Public Financial Management Performance Measurement Framework (as of 2005/06) that was published in February 2008.

⁴⁹ This was the case in five of the six municipalities visited.

⁵⁰ This was the case in the municipalities visited.

81. The institutional capacity of the Public Procurement Monitoring Office (PPMO), the lead procurement regulator and an independent complaints review mechanism, is low. The PPMO is also sometimes bypassed by the Council of Ministers.⁵¹ There is an absence of officials in GoN with significant experience and/or expertise in managing, regulating, executing, and overseeing procurement—especially at sub-national levels. Mechanisms to monitor implementation and performance, including efficient and reliable communication systems for timely reporting of procurement actions/status and instilling the culture of regular reporting is not effective.⁵²

82. There is a relatively limited degree of integration of procurement plans in the overall financial management system. Many grey areas, related to transparency and corruption in procurement, are apparent in the urban development sector:

- The ratio of bids submitted to documents distributed is very low, usually with submissions just meeting mandatory requirements.⁵³
- Collusion is rampant with successful bids very close to the budgeted provision.⁵⁴
- The practice of technical audits is nominal and there is low level of monitoring of procurement works.⁵⁵
- Threats, intimidation, and extortions are common practices.⁵⁶
- Bribes and corruption are accepted and taken for granted by the society.⁵⁷

83. The bid evaluation committees normally take a longer time than specified in the Public Procurement Regulations (PPR) to complete the evaluation process, resulting in unnecessary delays in awarding contracts. This often happens because the officials do not want to be pulled into unnecessary controversies and hence seek guidance and approval from higher authorities, even when they are mandated with sufficient decision making authority by the PPA. A similar problem is also prevalent in the selection of consulting firms. Such delays also lead to premature disclosure of information.⁵⁸

84. The local construction industry, which was also hard hit by the conflict, is weak partly due to the unstable business environment and also due to the prevalent institutionalization of corruption in the public sphere. This is also further aggravated by an environment of impunity that has persisted in recent years. This unstable business environment and situation of impunity has also bred an atmosphere that is conducive to cartelism and collusion without which it is difficult for contractors to get their hands on available contracts.⁵⁹ Many local construction companies are also owned and run by family members and hence nepotism takes precedence over professionalism. Though local contractors, who largely rely upon government contracts, lack capacity in bidding strategies and contract management, there are hardly any provisions to provide training to contractors.⁶⁰ At the moment, the Federation of Contractors' Associations of Nepal (FCAN) is protesting against certain provisions in the PPA. They have also alleged that they were not adequately consulted during the drafting and finalization of the PPA and

⁵¹ Example: The recent raising of the threshold from Rs. 3.5 million to Rs. 6.0 million on works to be performed by the community user's groups was decided by the Council of Ministers without consultation with the PPMO.

⁵² The officials of PPMO and municipalities interacted expressed this.

⁵³ The officials of Auditor General Office, who conduct performance audit on sample of local bodes, and officials of municipalities visited pointed out that though a large number bid documents are bought, submission come down to three, which is the mandatory requirement.

⁵⁴ As pointed out by the officials of the Attorney General Office, National Vigilance Centre and officials at the municipalities visited.

⁵⁵ As pointed out by the officials of the municipalities visited.

⁵⁶ As pointed out by representatives of FCAN and CDOs.

⁵⁷ This is the general opinion of all key stakeholders interviewed.

⁵⁸ This was cited by the FCAN and most of the officials in the municipalities visited.

⁵⁹ This was cited by contractors interviewed in Biratnagar.

⁶⁰ This was cited by all the officials of FCAN who interacted with the study team.

thus their ownership of the PPA is limited. The primary issue of concern raised by FCAN is presented in the table below:

Box - 3: FCAN's Primary Issue of Concern

The FCAN, which opposes many provisions in the new PPA, has been protesting with 45 demands for the amendment and abolishment of certain provisions in the Act as well as a few other issues. It has accused the government of being insensitive to its demands in spite of repeated assurances of addressing all issues through consultations with key stakeholders. The raising of the threshold from Rs. 3.5 million to Rs. 6.0 million on works to be performed by the community user's groups is one of its major issues as it perceives this as a threat to the very existence of some 12,000 small contractors operating at the local level. Though it appears that the raising of the threshold was done with a view to enhance community ownership and ensure downward accountability, serious reservations on the ability and skills of user's groups to implement projects involving this volume of fund have been raised by key stakeholders at the district level. They reported that user groups are generally compelled to implement projects in collusion with contractors who become members of user groups or complete the work on their behalf without documentary evidence of their involvement.

85. Bid advertisements, in the MPPW as well as municipalities, are tilted towards the last quarter of the fiscal year instead of the first quarter suggesting late start up of preparatory works.⁶¹ Submission of bids is hampered by threats and presence of hired thugs and hooligans.⁶² As a mitigation measure, the representatives of FCAN and the Chief District Officers (CDOs) interacted suggested that bids be submitted in multiple places. There is a difference in opinion among donors with regards to in bid submissions: DFID supports submission in multiple places while WB supports single place submission. There is a need for donor harmonization with regards to the number places where bids can be submitted.

4.1.3 Corruption

86. Several inter-related factors contribute to the growing corruption problems in the urban sector, the most significant of which are:

- A lack of transparency and access to information that surrounds many municipal functions and undermines nearly all aspects of accountability; this has hindered citizens' participation in policy discussions and oversight of municipality functions;
- Highly politicized administration, especially the appointment of the chief executive officer and division of staff along political lines and the existence of a "spoils system;"
- Limited political will and leadership to actually implement required reforms in accordance with the law; and
- Weak internal control systems⁶³ within municipalities.

The aforementioned systemic shortcomings⁶⁴ have allowed for an evolution of corruption in Municipalities that "follows the money" or where there is the most potential for financial gain.

87. There was a slight improvement in the corruption perception index (CPI) of Nepal in the Transparency International Survey Report of 2008. As against its rank of 131st.

⁶¹ This was reported by officials in all municipalities visited and the MPPW.

⁶² This was reported by officials in all municipalities visited, the CDOs interviewed and the officials in the MLD and the MPPW.

⁶³ Some of these are: i) ineffective internal audit; ii) no incentives for staff who perform well and punishment for those who abuse authority or do not perform their duties; iii) absence of performance and evaluation systems; iv) absence of effective monitoring systems for procurement of works and services etc.

⁶⁴ These observations are based on the information provided by the CIAA, officials of the auditor general, chief district officers and municipalities' staff.

with a CPI score of 2.5 in the year 2007, Nepal was in 121st. position out of the total 180 countries listed in the CPI with a score of 2.7 in the year 2008.⁶⁵ Though Articles 119, 120 and 121 of the Interim Constitution of Nepal, 2006, have empowered the CIAA to investigate and probe cases of corruption and abuse of authority against persons holding any public office and their associates, corruption remains a key governance challenge as legislative compliance is weak while anticorruption organizations lack consistency in terms of jurisdiction and suffer from low capacity.

88. The proportion of cases filed against complaints received by the CIAA has gone down during the last five years, with 2.6% cases filled in fiscal year 2007/08 as against 3.7% in fiscal year 2002/03. The conviction rate of high profile corruption cases filed in the Special Court remains very low with the CIAA moving the Supreme Court for review of the Special Court's verdict. With instances of petty corruption being rampant in all sectors, it has become a way of normal life and a socially accepted norm in Nepal. This is also true for the urban development sector. Though segregated data, pertaining to specific agencies and municipalities, is not available in an organized form in the CIAA, the national situation can also be extended to the municipalities and line agencies involved in urban development.⁶⁶

89. The CIAA is mandated to investigate corruption cases and prosecute abuse of authority by public officials all over Nepal. However, it is located in Kathmandu without a formal regional and district based presence of its own. At the district level, the district administration, with the Chief District Officer (CDO) at the helm, has been vested with the authority to act on the CIAA's behalf. To support the district administration, a legal officer has been deputed in some districts by the CIAA. The jurisdiction of investigating and deciding on complaints involving non-gazetted officers has been vested on the CDO while the District Administration Office (DAO) assumes the role of an investigator in the case of complaints related to gazetted officers. Related files pertaining to gazetted officers are forwarded for further action to the CIAA with appropriate recommendations.

90. Though the CIAA has delegated its authority on preliminary investigations to the five Regional Administrators and the seventy five CDOs as per the notice published in the Gazette of 15 January 2007 and deputed legal officers to some districts, reported cases of corruption remain low⁶⁷ and mostly unresolved at the local level. Cases are generally forwarded to the center as the staff are overworked, lack investigation skills, and are subject to constant political pressure.⁶⁸ Though no sectoral data is available and the reporting of procurement cases is low, corruption in municipality and urban infrastructure sector is increasing and largely unchecked.⁶⁹

91. Technically it is extremely difficult for the CIAA to investigate corrupt officials at the district level by relying on the District Administration Offices, which are accountable to their own ministry rather than to the CIAA and lack the institutional capacity to investigate cases of corruption. Members of the public may report instances of corruption to the CDO, in person, by post, or by telephone. However, whatever the initial means of notification, all complaints must be submitted in writing before they can be taken up formally. In addition to cases originating from complaints received from the public, cases may originate from within the District Administration Office on the basis of media reports on corruption. Cases may also be referred to the CDO by the CIAA (e.g.,

⁶⁵ A score of 5.0 is the number Transparency International considers the borderline figure distinguishing countries that do and do not have a serious corruption problem.

⁶⁶ CIAA and opinion expressed during interaction with CIAA officials and CDOs.

⁶⁷ As shared by CDOs in the district visited.

⁶⁸ As shared by CDOs in the district visited.

⁶⁹ This was cited by the CDOs and CIAA

where the CIAA receives a complaint directly and decides that it can best be investigated at the district level).

92. When complaints are received, they are recorded in a register and a file is opened. The legal section of the DAO, which carries out an initial investigation of the complaints, can also request assistance from the police, if necessary (e.g., to gather evidence). The purpose of the initial investigation is to establish whether there is a case to be heard. The initial investigation is important because some complaints are baseless and made on malicious grounds.

93. When the detailed investigation is complete, the CDO can close the file, take necessary action within his authority, or forward the case file to the District Attorney with recommendation for further legal action. The District Attorney reviews the file and if both the CDO and the District Attorney think the case should not be taken further, the matter is dropped. The file is retained in case there are further developments. If both of them think legal action should be taken, the file is sent to the CIAA to initiate relevant action. If there is disagreement on what should be done, the file is sent to the CIAA for a decision. Where legal action is taken, the CIAA files a case at the Special Court in Kathmandu.

94. The CDOs interacted at the district level opined that they are overworked and cannot spare much time and have nominal resources (human as well as financial) for corruption cases. As the top priority is accorded to maintaining law and order, corruption cases usually take a back seat. The district administration has not been allocated additional funds for this new responsibility. Expenditure on corruption cases are not accounted under a separate heading.

95. The CDO reports to the CIAA on cases that are referred to by the CIAA, but not on cases that originate in the district. There is a monthly reporting system to the Home Ministry (the district administrations' parent Ministry) but this is not comprehensive and is primarily limited to stating the number of complaints and their current status. Responsible officers at the district level are seldom provided training on the investigation of corruption cases. There is no system of periodic visits by the CIAA to provide guidance or oversight.

96. No serious effort to encourage the public to report corruption cases is made by the District Administration Office. It appears likely that many people are unaware that complaints can be registered at the CDO office. The responsibility for public education is generally taken by civil society organizations who work on good governance issues.

97. District-based stakeholders are of the opinion that a centralized provision of dealing with all corruption cases in the Special Court in Kathmandu poses many problems. Sending officials to Kathmandu for trial imposes administrative and financial burden on the CDOs, which may be a disincentive to taking forward corruption cases. Costs must be met from the district budget. It was suggested that there should be more Special Courts, at least one in each region. There was also a strong feeling that CIAA regional offices would be of great value.

98. The civil society and donors in Nepal have for long been citing the prevalence of rampant corruption in local bodies with low downward accountability to the general public. Corruption in local bodies, including municipalities, ranges from a demand for small amount of money for expediting a minor bureaucratic task to huge bribes and embezzlement of large amount of funds allocated for infrastructure projects. Thus, besides the citizens' scarce resources being expended for services that should be delivered free of cost, they are also deprived of the required standard of infrastructure facilities as corruption adversely affects and compromises on the quality of works.

99. There exists an environment conducive to leakages and lack of accountability. Many irregularities and recommendations pointed out in auditor's reports are often overlooked despite commitments to rectify these deficiencies by the concerned municipalities. Collusion among contractors and between contractors and municipal officials was reported to be rampant by all the stakeholders. It is also alleged that there is large scale corruption in the first assessment of the Integrated Property Tax (IPT) with collusion between officials of the municipalities and most of the taxpayers resulting in low property valuation and reduced revenue collection on a continual basis.

100. The culture of reporting corruption cases and complaining against irregularities is low with the tendency of accepting petty corruption as a mean to get one's work done ingrained in the people's mindset. Most people go by the dictum that it is wise to get one's work done on time by bribing officials rather than lodging complaints to higher authorities. As collusion between the boss and subordinates is a common practice, people's faith on the success of complains and improvement in services is nominal. As a result, the incentive to complain against corruption and irregularities is highly eroded.⁷⁰

101. Corruption is recognized as one of the chief causes of Nepal's underdevelopment. It is very widespread, has many different manifestations, and is practiced at all levels of society. The business and contracting sectors are most seriously affected by, and involved in, corruption. The contractors, politicians, government officials, and even consumers are responsible for this. Many different forms of infrastructure-related corruption add greatly to the cost of doing construction works in Nepal. This has severely damaged the competitive strength of Nepalese contractors. It has also, in many instances, increased the cost and undermined the quality of goods and services available to consumers, and deprived the government of much needed revenue. Those most often accused of perpetrating corrupt acts are government officials, politicians, contractors, and business persons. With anti-corruption initiatives having been focused mostly on corrupt government officials and politicians, little attention has been given to clamping down on corrupt contractors and on addressing the problem of contracts-related corruption.

102. Many requirements that user groups need to follow are not being adhered to. Mechanisms such as public hearings, social audit, community audit, and public audit are being initiated by civil society organizations but are yet to be institutionalized by municipalities though the pressure to do so is increasing on account of donor-funded projects that make these processes mandatory. Corruption is a chronic problem in Nepal and is a serious concern for all. Civil society organizations have recently shown concern about public officials being involved in grand and petty corruption.

4.2 ADB project systems

4.2.1 ADB's urban sector strategy

103. ADB's Medium Term Strategy (2006-2008) highlighted urban infrastructure as one of the core sectors in which ADB needs to expand its program. The Urban Sector Strategy, 1999 guides ADB's investments in the urban sector. The operational objectives of the strategy are to maximize economic efficiency of urban areas, improve quality of life, achieve more sustainable forms of urban development and reduce urban poverty. These objectives are envisaged to be achieved through the promotion of urban sector policies for promoting good governance, mobilizing financial resources, improving urban management and improving the design and delivery of integrated urban infrastructure

⁷⁰ This was the view of the CDOs interviewed in Biratnagar, Bidur and Nepalganj.

development projects or sub-sector projects: water supply, sanitation, and solid waste management; land management; transport; and housing.

104. To ensure the strategy's continuing relevance and effectiveness to ADB's operations, in 2007, ADB conducted two interrelated independent reviews of the urban sector strategy: one by ADB's Regional and Sustainable Development Department (RSDD), and the other by ADB's Operations Evaluation Department (OED). The RSDD's report, which reviewed the strategy, found that most features of the strategy were relevant and suggested that the strategy be supplemented by more practical guidance on dealing with issues arising in individual countries. The OED report, which focused on the appropriateness and implementation of the strategy, rated ADB's operations in this sector as broadly successful.

4.2.2 Financial management and implementation

105. The designated Executing Agency (EA), the MPPW in the case of projects related to urban development, is responsible for formulating and guiding urban development sector activities to meet objectives and targets outlined in the national development plans and policies and has the overall responsibility for ADB funded projects. The Implementing Agency (IA), primarily the Department of Water Supply and Sanitation (DWSS), Department of Roads (DoR) and DUDBC are the lead agencies in projects related to the urban development sector. Specific Project Management Office (PMO), with the support of consultants, manages ADB funded projects on a day-to-day basis and is responsible for overall implementation and coordination.

106. For disbursements, imprest accounts are established, managed, and liquidated in accordance with ADB's *Loan Disbursement Handbook*. Statement-of-expenditure (SOE) procedures may be used to reimburse eligible expenditures and to liquidate advances made into the imprest account in accordance with the guidelines. The implementing agency coordinates the timely release of funds. Auditors, satisfactory to ADB, audit the use of the imprest account and SOE procedures. A separate audit opinion on the use of the imprest account and SOE procedures are in the annual audit report. The audit reports from the Office of the Auditor General have affirmed that the financial statements from ADB project offices under MPPW gave a true and fair presentation of the financial positions of the project accounts.

107. In the Small Town Water Supply and Sanitation Sector Project funded by the ADB, a project management office (PMO) under the DWSS was responsible for project implementation. The PMO set up a town project office in each Project town to coordinate inputs from consultants, non governmental organizations (NGOs), Water User and Sanitation Committees (WUSCs), contractors, and local governments. Sub loans were provided to WUSCs to cover 30 percent of the construction cost of a water supply scheme. The TDF, a semi-autonomous urban finance institution, was engaged to disburse and collect the sub loans. A project coordination committee was established to coordinate overall project activities. The TDF has been given the responsibility for overseeing the financial sustainability of projects. It did this by examining the town project costs and projections in connection with the debt servicing capabilities of the local governments and the implementing agency. It also provided basic training in revenue planning, bookkeeping and accounting to related offices of the implementing agencies, disbursed and collected loans; ensured that the funds were used for the intended purposes; exercised other due diligence as required of a prudent financial institution and participated in procurement activities related to the project implementation.

108. In the ongoing Urban and Environmental Improvement Project (UEIP), the MPPW is the EA for the Project. It discharges its duties through the DUDBC, which has established a project coordination office (PCO) for the Project. The participating municipalities are the IAs for the majority of the subprojects. Implementation at the municipal level is being managed using one of two possible models: the project advisor (PA) model and the project implementation unit (PIU) model. The PA model is preferred by two municipalities with relatively advanced institutional capabilities (Bharatpur and Hetauda), while the PIU model is preferred by the remaining six municipalities whose institutional capabilities are still weak. The PA model envisages that the municipal administration will essentially be in charge of implementation management, assisted by a PA without executive function. The PIU model envisages that a PIU will be formed and staffed by the EA, and will assume the executive function for managing implementation, subject to general guidance from the municipality concerned. Considering the limited personnel resources at DUDBC, from which secondment staff can be drawn for PAs/PIUs, a staggered implementation schedule is being used.⁷¹

109. Project implementation delays in ADB funded projects, in Nepal, are comparatively higher than the South Asian and the overall ADB average. This is validated by the fact that, during the period 2004 - 2008, 38.2% of the projects experienced delays in comparison to 32.6% in South Asia and 25.0% overall ADB average. Likewise, significant disbursement delays on the part of the counterpart in Nepal (34.2%) were also higher than the South Asian average of 16.5% and the overall ADB average of 29.7%. The overall risk ratio of ADB funded projects in Nepal, at 15.4%, is also higher than the South Asian average of 12.6% and the overall ADB average of 12.1%. The average loan extension of ADB projects in Nepal, during the period 2004 - 2008, was 2.01 years with increasing trend from the year 2006 onwards.⁷² However, the delays and risk associated with ADB projects in Nepal must be judged taking into perspective the overall difficult situation in this period during which implementation of projects were adversely affected by the conflict, frequent *bandhs* (closure) and strikes and the long standing environment of impunity in the country.

110. The foregone findings were validated by the TDF officials. The information provided by them is presented in the box below:

Box - 4: Small Town Water Supply and Sanitation Sector Project: Cost and Time Overruns
<ul style="list-style-type: none"> • Most projects experienced time overrun and many requested additional loan • Though the first installment was already due in the case 16 out of the 29 towns (55%), the projects' implementation was still ongoing. • There appeared high variation in project cost estimates • The project techno-economic viability was affected as revenue assumptions were inclined towards making project viable. • Ensuring user groups' contribution was difficult and usually late. • Local bodies' involvement and ownership was limited to the role of a guarantor with nominal involvement in project activities. • Repayment of loans can be a problem as actual revenue are not in alignment with projections. • Monitoring of projects during implementation need to be increased by ADB.

⁷¹ Source: Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Kingdom of Nepal for the Urban and Environmental Improvement Project, November 2002.

⁷² Source: Central Operations Services Office as cited by Country Assistance Program Evaluation, Nepal, Draft Report, March 2009.

111. Likewise, the findings of the "Benefit Monitoring Evaluation of the Small Town Water Supply and Sanitation Sector Project" report, dated November 30, 2008 that was under taken by the consulting firm, New ERA, highlighted the following problems encountered by the Project:

- Operation and maintenance activities of Water User and Sanitation Committees (WUSCs) have been ineffective because of poor management system; shortage of manpower including skilled manpower; lack of equipment and technical know how. This can result in higher maintenance cost and loss in revenue on account of break downs.
- The initial loan recovery trend is not satisfactory. This is mainly due to low income resulting from low number of tap connections (37.9 percent tap connection against the project design) and low water tariff collection. The sub-projects have lower tariff rates than the design estimates and will not be sufficient for the sub-projects to cover the costs for operation, maintenance and loan repayment to make them financially sustainable. Based on the current saving from recurrent net income, none of the sub-projects seems capable to payback the TDF installment.
- NGOs are one of the vital bodies entrusted with an important role and function i.e., mobilization of people for cash and kind contribution, development of community awareness program (CAP), preparation of socioeconomic profile, capacity building tasks of WUSCs, health workers, and training and awareness campaign at community level, promotion and support for household and community level sanitation facilities. However, NGO activities were found minimal with reference to their scope of work in project preparation phase. In most of the cases, NGOs came into action during the construction phase.
- WUSC expressed their constraint and inadequacy in performing some of their roles effectively as they lacked technical knowledge, i.e., project design appraisal, ensuring quality, central supervision and monitoring of construction works, and quality of construction materials. Out of 25 major responsibilities assigned to them 15 are technical in nature. Absence of a technical person in WUSC was sorely felt by all the WUSCs.
- Despite appreciating the training inputs given by the TDF on financial aspects i.e. planning, budgeting, book keeping and tariff setting; quality control, supervision and monitoring of construction work and materials by engineering design consultant (EDC); on hygiene and sanitation by NGOs; and on water quality tests by PMO, WUSCs felt their inability to do their job satisfactorily. These training were neither detailed enough nor do WUSCs have enough human resource to carryout these activities. It is found that a single person was often made responsible to carry out a number of activities – tariff collection, regular operation and maintenance work, and ensuring water quality.

4.2.3 Project procurement systems

112. In Nepal, all projects in the urban development sector, supported by the ADB, have followed the ADB's Procurement Guideline, 2007. The Public Procurement Act (PPA) makes an exception for donor funded projects as it mentions that procurement process in such projects can be in accordance with donors' procurement guideline if such provisions are made in the agreement between the GoN and the donor agencies. The Guidelines are applied for the procurement of goods and works for projects in line with the financing agreement, which governs the legal relationships between the borrowers and ADB. The rights and obligations of the borrower and the providers of goods and works for the project are governed by the bidding documents, and by the contracts signed by the borrower with the providers of goods, works and services. To encourage competition, ADB permits, joint or independent, international competitive bidding (ICB) providing equal opportunities to bidders from eligible member countries to

offer goods, works, and services for ADB financed projects. The bidding document explains all relevant details related to the bids including the type and size of the contract. ADB's project officials have stated that they do not have major difficulties in following the ADB guidelines.

113. As part of the preparation of the project, the borrower needs to prepare, before loan negotiations, a procurement plan acceptable to ADB and submit the same to ADB for approval. The Plan needs to set forth: (a) the particular contracts for the goods, works, and/or services required to be carried out by the project during the initial period of at least 18 months; (b) the proposed methods for procurement of such contracts that are permitted under the financing agreement, and (c) the related ADB review procedures. The plan is required to be updated on an annual basis or as needed always covering the next 18 months period of project implementation. Prior approval is needed for any revisions proposed to the procurement plan.

114. In the Urban Environmental Improvement Project (UEIP) and the Small Town Water Supply and Sanitation Sector projects, procurement related to civil works and supplies, at contract value at more than \$1.0 million are/were awarded following international competitive bidding (ICB) procedures and a contract valued at or below \$1.0 million are awarded following local competitive bidding procedures. Procurement of minor materials and civil works can follow direct purchase procedures with joint concurrence of executing agencies and implementing partners. Procurement of equipment and vehicles follow ICB procedures for contracts valued at more than \$500,000, international shopping procedures for contracts valued at \$500,000 or less, and direct purchase procedures for contracts valued at \$100,000 or less. Minor works for the development and maintenance of project facilities may be carried by the executing agency on a force account basis.

115. Stakeholders, officials of government agencies, local bodies and representatives of FCAN, have stated that while this is the right approach for ICBs, there is a need for national competitive biddings (NCBs) to be governed by the PPA, which was formulated through donors' support to harmonize donors' requirements. Officials of government agencies and municipalities stated that ADB projects are also affected by collusion, bid-rigging and cartelism in procurement of goods, works and services at the local level. The Nepalese construction industry, which have been hard hit by the recent conflict and deteriorating security situation, have requested the ADB to review some of its prevailing procurement requirements. The crux of their argument is that ADB's bid requirement need to be simplified to help them grow and be competitive by the time World Trade Organization (WTO) provisions are fully applied in Nepal.

Box - 5: FCAN's Request to the ADB

- For any procurement under the NCB, PPA provisions should be made applicable in the case of ADB funded projects also while Clause 67 of the PPA, which can exempt donor funded projects from the provisions in the procurement process as specified in the PPA be applied to ICBs only.
- General experience of contractors should be made applicable in alignment with Public Procurement Regulation 26 (Consideration of a ten year period with average turnover based on three years of maximum turnover).
- Price adjustment during the period of the contract should be made in line with the price index published by the Central Bank.
- Submission of bids in more than two different places to minimize threats to and collusion of contractors should be allowed.

4.2.4 Corruption

116. ADB emphasizes and attaches great importance on accountability for public officials, and transparency and predictability in government operations and critical principles in the fight against corruption.⁷³ “The policy’s emphasis upon strengthening the essential prerequisites for effective public administration and is designed to ensure that the fundamental building blocks for transparent, predictable and accountable administration are in place. These building blocks include an appropriate legal framework and effective enforcement mechanisms; a professional, competent, motivated and meritocratic civil service; transparent procurement practices; effective internal control systems; and a well-functioning independent audit office”.⁷⁴ More specifically ADB’s approach to address issues of corruption is based on three basic objectives;⁷⁵ i) supporting competitive markets and transparent and accountable public administration; ii) supporting promising anticorruption efforts and enhancing quality dialogue with Developing Member Countries (DMCs); and iii) ensuring that ADB projects and staff adhere to the highest financial and ethical standards. In Nepal, ADB funded urban development sector projects have rarely been reported for corruption to the District Administration Office or the CIAA.

117. Municipalities are vulnerable to corruption in various forms and levels. Petty corruption in urban development sector was widely reported by all the CDOs in the districts visited. The award of contracts and implementation of projects through user groups (UGs) is allegedly fraught with corruption in the form of; political interference, nepotism and conflict of interest; procurement and tender-related corruption; lack of ethical values and standards within the local bodies; and construction related irregularities associated with the use of sub-standard materials. Corruption risks also arise from ineffective monitoring and control mechanism, inadequate technical human resources in municipalities, poor communication systems and poorly articulated and enforced standards and regulations.⁷⁶ In general, ADB’s projects also encounter similar corruption risks prevalent in the overall urban development sector.

4.3 Climate Change: A Cross Cutting Issue

4.3.1 Introduction

118. Nepal’s ecosystems are increasingly threatened by a rapidly growing population that is putting pressure on its fragile natural resource base including land, water, and forest resources. As rural population rely heavily on natural resources for their livelihood, the deterioration of environmental and natural resource base has contributed to chronic rural poverty and migration to urban areas in Nepal and out migration to India and other countries. Uncontrolled urbanization has contributed to environmental degradation associated with the poorly managed disposal of solid and industrial wastes and other forms of pollution. This is further aggravated by increased intensity and frequency of extreme weather events attributed to anthropogenic climate change, making it extremely difficult to ensure environmental sustainability and human security.

119. The climatic condition in Nepal varies from the tropical to the arctic within the 200 kilometer span from the plains of the south to the mountains of the north. Average rainfall is 1,500 mm, with rainfall increasing from west to east. Although annual rainfall is abundant, its distribution is of great concern: flooding is frequent in the monsoon season

⁷³ R151-95: Governance: Sound Development Management, 17 August.

⁷⁴ ADB, Anticorruption, Our Framework Policies and Strategies, 2001.

⁷⁵ ADB, Anticorruption, Our Framework Policies and Strategies, 2001

⁷⁶ This was cited by representatives of donor organizations and many other stakeholders.

during the summer, while droughts are not uncommon in certain regions in other parts of the year.⁷⁷

4.3.2 Impact on urban development

120. In Nepal, critical urban infrastructure (e.g., roads, bridges, sewages, and electricity and telecommunication systems) that are vulnerable to damage from extreme events (floods, landslides, storms) are not designed with climate change predictions in mind. The Environmental Impact Assessment (EIA) processes of infrastructure projects do not explicitly require consideration of climate change impacts. There is limited capacity to include climate change considerations in project designs and into the existing EIA process.⁷⁸ Consequently, projects are not being fully assessed from an overall ecological sustainability perspective and as a result important climate change considerations are overlooked during project planning and design. Thus, implementation of mitigation measures and monitoring programs are not in place to counter the hazards posed by extreme events caused by climate change. More importantly, project proponents and EIA administrators both require critical guidance on how to assess both climate change mitigation and adaptation issues, and identify appropriate green house gas (GHG) reduction, energy conservation and risk reduction measures to ensure a sound and technically viable project.

121. Water availability and water quality are also affected by climate change. Temperature observations in Nepal from 1977 – 1999 demonstrate a general warming trend. Due to such rising temperatures, Nepal's glacial lake outburst floods (GLOFs) is becoming a great concern.⁷⁹ Glaciers and snowfields will recede and may even disappear, reducing Nepal's dry season river water source. This will impact irrigation and drinking water supply, as well as the reliability of hydroelectricity. Receding glaciers often leave behind growing glacier lakes that can break through terminal moraines causing catastrophic floods. Nepal has experienced several severe floods from rapidly draining glacier lakes.⁸⁰ Poor and inadequate drainage facilities have made urban areas extremely vulnerable to excessive flooding and water logging during the monsoon. All these factors have a severe impact on urban areas which have to deal with acute shortage of electricity, drinking water, and other physical infrastructure and yet cope with the increasing demand for basic services.

122. Further, on the financial side, economists seldom analyze the policies on climate change and of investments for mitigation and adaptation including the economics of risk and uncertainty, innovation and technology, development and growth, international trade and investment, financial markets, and public finance. Similarly, procurement processes and procedures do not recognize the risk associated with climate change to ensure that infrastructure design and construction are climate proofed. Likewise, lack of strict implementation and monitoring of existing provisions related to environmental standards and requirements are not adhered to by urban projects owing to collusion between regulatory officials and project proponents.⁸¹

⁷⁷ OECD and OCDE, Development and climate change in Nepal: Focus on Water Resources and Hydropower, 2003.

⁷⁸ All the technical personnel interviewed in municipalities and line agencies stated that climate change was not considered in project planning and designs while EIAs were largely silent on this aspect. They also stated that this capacity did not exist in municipalities.

⁷⁹ The most significant GLOF incident in terms of recorded damages occurred in 1985 causing a 10 to 15 meter high surge of water and debris to flood down the Bhote Koshi and Dudh Koshi for 90 kilometers, which destroyed the Namche Small Hydel Project

⁸⁰ OECD and OCDE, Development and Climate Change in Nepal: Focus on Water Resources and Hydropower, 2003.

⁸¹ This was cited by most of the key stakeholders interviewed during the course of this study.

4.3.3 Government policies

123. Nepal signed the General Convention on “Biological Diversity and Climate Change” during the Earth Summit in the year 1992. Environment Protection Act and Environment Protection Regulation were formulated in 1997 and 1998 respectively.⁸² GoN has been attempting to integrate environment conservation activities in development and gradually environmental factors with sectoral policies and programs. Although many of these provisions were tailored to address environmental and sustainable development issues, many of them were not implemented due to lack of a single integrated policy, inter-sectoral coordination and poor monitoring and supervision mechanisms. Further, many of the systems and policies, and Acts are not well adjusted to address today’s issues of climate change. Like many other developing countries Nepal is focusing its policies mainly on addressing the issues of ensuring food security and poverty reduction.

124. At the government level, there is a perception that climate change needs to be addressed. Accordingly, national policies are needed to be designed and the government is working to that end, but the pace is too slow. The problem in Nepal is that, firstly, there is an overarching thought that “climate change is an international agenda, a global agenda propagated by the donor community.”⁸³ Primarily, there is a lack of awareness at the government level on what climate change is. Climate change is dealt with by the Ministry of Science and Technology, but the actual policies and programs need to be designed by other sectors like agriculture, production and infrastructure sectors. Many of the urban policy makers and planners do not take into consideration the implication of climate change in urban development policies and plans.

5.0 DONOR ENGAGEMENT

5.1 Current and planned donor support and financing mechanism

125. In comparison to the rural sector, few development agencies are involved in the urban infrastructure sector assistance. The World Bank, United Nations Development Program (UNDP), GTZ/German Development Bank (KfW) and ADB have been major donors involved in the development of urban governance and infrastructure. The UNDP and GTZ/UDLE have long experience in the capacity building of municipalities and government institutions involved in the urban development sector. The ADB and the World Bank have been involved in the capital development projects since the last 15 years.

126. **The World Bank⁸⁴:** According to the Articles of Agreement by which the World Bank is bound, loans are provided to a country only through its national government. While ideas for new projects can be identified by various parties, only the central government can formally propose a specific project and request financial assistance from the Bank. The Bank’s method of operation is to provide financing and advice for projects which are a logical part of a comprehensive development agenda. The World Bank’s loans are at little or no interest and also have a much longer period to repay. In some cases, repaying starts from ten years.

127. The World Bank also provides lending support and policy advice in the areas of financial sector reform, local government and private sector participation in basic infrastructure services. The Bank works with multiple development partners: The

⁸² Sunil N. Lohani, Climate Change in Nepal – Shall we Wait Until Bitter Consequences?

⁸³ Sharma, www.myrepublica.com/portal/index.php?action=news_details&news_id=5875

⁸⁴ www.worldbank.org.np

government, other bilateral and multilateral donor organizations, nongovernmental organizations (NGOs), the private sector, and the general public—including academics, scientists, economists, journalists, teachers, and local people involved in development projects. The UNDP-Nepal and the World Bank co-chair regular meetings of the wider donor group based in Kathmandu. In addition, the World Bank chairs the Nepal Development Forum (formerly known as the Nepal Aid Group Meeting), usually held every 18 months.

128. **United Nations Development Programme (UNDP)**⁸⁵: The Government of Nepal and its respective ministries and agencies at central, district and local level are important counterparts for the UNDP. In addition, the UNDP partners with donor agencies, international and national non-government organizations (NGO), civil society organizations and community based organizations. The UNDP program activities in Nepal are funded primarily from three sources: UNDP regular resources; various UNDP Thematic Trust Funds earmarked for the specific thematic areas; and direct contributions from donors under bilateral agreements. The total resources to be mobilized in support of this United Nations Development Assistance Framework (UNDAF) for the period 2008 – 2010 are estimated at approximately USD 360.4 million. This total includes resources that form part of the core funding of UN agencies operating in Nepal as well as funds to be mobilized through external partners.

129. **German Technical Cooperation (GTZ)**⁸⁶: The GTZ and GoN have agreed that the GTZ's activities should focus on the following priority areas at present; Local Self-Governance and Civil Society and Renewable Energy Health and Family Planning which are integrated into the four pillars of Nepal's Poverty Reduction Strategy (PRS): Broad Based Economic Growth, Human Development, Social Inclusion and Governance.

130. The GTZ cooperates locally with other bilateral and multilateral donors and agencies. The GTZ is working closely with other German and international institutions (German Development Service (DED), German Development Bank (KfW), Center for International Migration and Development (CIM)) also within the framework of the Paris Declaration on Aid Effectiveness. In addition, the GTZ coordinates its activities with development cooperation organizations from other European countries such as the United Kingdom, Denmark, Norway and the Netherlands, as well as with international organizations, for example the Asian Development Bank (ADB), the International Labor Organization (ILO), the United Nations Development Programme (UNDP) and the World Food Program (WFP).

Box - 6: Prominent Ongoing Urban Development Programs of other Donor Agencies

The UNDP funded Public-Private Partnership for the Urban Environment (PPPUE), which was launched in March 2002 and operates in 10 partner municipalities in Nepal, supports pro-poor Public-Private Partnership (PPPs) in urban services provision and infrastructure development. PPPUE project activities focus on the provision of the most essential urban services to the poor, namely, water supply and distribution, sanitation – waste water collection and removal, solid waste management – and, to a lesser extent, renewable energy, roads and urban transportation management.

The Town Development Fund (TDF), initially established as the TDF Board by Formation Order 1988 under the Development Board Act 1956, was made autonomous in 1997 under a new act, called the TDF Act. The TDF provides financial support to municipalities to implement social infrastructure and income-generating projects and strengthens the technical, managerial and financial capabilities of municipalities in the formulation, implementation and evaluation of urban development plans and programs. The ADB also provides financial support to the TDF.

The GTZ's Urban Development through Local Efforts (UDLE) program has worked to

⁸⁵ www.undp.org.np

⁸⁶ www.gtz.de/Nepal

improve public expenditure management and financing in municipalities in Nepal since 1986. It focuses in reducing urban poverty through socially inclusive urban development.

5.2 Summary of recent ADB's engagement and lessons learned

5.2.1 ADB's recent engagement

131. Recent ADB's engagements in the urban development sector are as follows:

- The **Town Development Fund (TDF)** provides financial support to municipalities to implement social infrastructure and income-generating projects and strengthens the technical, managerial and financial capabilities of municipalities in the formulation, implementation and evaluation of urban development plans and programs.
- The **Small Towns Water Supply and Sanitation Sector Project**, with the financial assistance of the ADB, was part of the 15-year plan for small towns' water supply and sanitation development. The project focused on providing water supply, limited drainage and sanitation facilities in 40-50 towns following a demand-driven, interactive procedure that ensures full participation of the local water users' groups.
- To address this institutional failure on critical urban environmental issues, the GoN, with the support of the ADB initiated the **Urban Environmental Improvement Project**. The project intends to bring about sustainable urban development in the nine urban areas outside Kathmandu Valley by improving essential urban and environmental infrastructure and services and strengthening the relevant institutions.
- **The Local Governance and Community Development Program (LGCDP)** is a major GoN initiative, which will contribute to poverty reduction through inclusive, responsive, and accountable local governance and participatory community led governance. The program will be implemented in all the 75 districts and cover all local bodies including municipalities. The program, which is estimated to cost \$ 470.00 million, will be financed by the GoN (\$ 260.8 million), the ADB (\$ 106.3 million) and other development partners who have expressed commitment through signed letter of intent.⁸⁷

5.2.2 Lessons learned

132. Over the years of ADB's assistance to the country and the sector, valuable lessons have been learned. Major lessons learned cited by the Country Assistance Program Evaluation (Draft Report), March 2009, 1999 Country Synthesis of Evaluation Findings and project documents on urban infrastructure are as follows:

- The efficiency and sustainability of ADB-funded infrastructure projects were affected not only by the conflict but also by the policy, institutional and capacity constraints in infrastructure (particularly the lack of reform), and by the low level of public investment. There is therefore a need for strategic clarity and prioritization so that the small rural infrastructure and large urban infrastructure development could be appropriately timed and sequenced.
- Community-based projects need to be consistent with the capacity building particularly at the local level. Reform for local government finance and a system for supervision for civil society organizations (CSOs) need to be put in place as key steps to gradual decentralization. This need to take place simultaneously with clarification between national and local roles, and the number of districts, regions,

⁸⁷ Report and Recommendation of the President to the Board of Directors, Project Number: 36172: Proposed Program Cluster and Grant for Subprogram 1 Federal Democratic Republic of Nepal: Governance Support Program, ADB, 2008

CSOs with which the ADB operates should be consistent with its capacity for project design and implementation support.

- Development experience of ADB and other aid agencies suggests that participation must go beyond consultation to focusing on empowerment of the communities in the development process. The commitment of beneficiary communities, in terms of capital cost contribution and timely setting up of community-based user's groups is essential to successful implementation and sustainability of the projects. Such commitment, however, can be obtained only by involving the communities in planning, design, and operation and management the projects, which in turn requires comprehensive education and interaction with the local communities.
- Major lessons learned from ADB's previous urban infrastructure development projects in Nepal were as follows:
 - Complex and multi-component projects should be avoided where the executing agencies (EAs) have limited experience. Institutional capacities with respect to land acquisition, procurement of consultants, etc. should be thoroughly explored,
 - Physical works should be tendered in relatively large packages to attract bigger and more experienced contractors. No contractor should be allowed to bid for further packages before they have substantially completed their current project,
 - Likewise, consulting services should be tendered in relatively large packages to attract bigger and more experienced consultant companies. This is also to reduce the workload of coordination for the EA/implementing agency (IA),
 - Advance procurement action, especially for consulting services, should be seriously considered to reduce delays at project start-up,
 - Project implementation scheduling should be realistic and take into account the time needed for IAs to constitute themselves; for inexperienced IAs to conduct the tendering process in accordance with ADB's guidelines; for municipalities and communities to provide their contributions; and foreseeable delays caused by a project's location, seasonal adverse weather conditions, and festivals and holidays,
 - Consulting services should be guided following interactive processes, working closely with the target groups, producing user-friendly outputs, and emphasizing hands-on advice and on-the-job training instead of mere production of reports,
 - Project designs should incorporate better environmental monitoring mechanisms, including the collection of baseline data,
 - ADB review missions need to supervise more closely the quality of project implementation, even though some project locations may be remote. They also need to focus more on institutional and social concerns, and encourage frequent and intensive interaction between EA, IA, and the beneficiaries.
 - Cancellation of important components for reasons of slow progress arising from lack of funds should be avoided as far as possible, especially when they are critical to overall achievement of project objectives.
 - Project activities that depend on a new legislation/legislation change need to be minimized or these should be done upfront as conditions for Board consideration.

6.0 SUMMARY RISK MATRIX

133. From the foregone findings, it can be concluded that the urban development sector faces many risks associated with financial management, procurement, and corruption. The summary of these risks is presented hereunder:

	Risk Identified	Likely	Relatively Serious	Not Mitigated over the CPS Period	Major Risk
A) COUNTRY SYSTEMS					
I) FINANCIAL MANAGEMENT RISKS					
i) Legislative and Policy Framework					
	The LSGA is silent on non compliance of mandatory provisions related to planning, implementation and monitoring and evaluation.	X	X		
ii) Institutional Framework and Capacity					
	The institutional capacity of municipalities to manage their finance, in terms of professional human resource and accounting system, is low.	X	X	X	X
	Lack of effective mechanisms for accountability and transparency, and checks and balances on power	X	X		
	Ineffective internal controls, audit, monitoring and evaluation systems	X	X	X	X
iii) Budget Formulation, Execution, Accounting and Oversight					
	Low level of participation of stakeholders at the ward level during the planning and budget formulation process	X	X		
	Lack of coordination between budget formulation and policy and/or operational and investment needs (lack of periodic plans)	X	X		
	Absence of a comprehensive capital investment strategy.	X	X		
	Unrealistic budget based on programs to appease key stakeholders with				

	optimistic revenue forecast to match expenditure budget	X	X	X	X
	High dependence on government grants and Local Development Fee	X	X	X	X
	Absence of systematic assessment of revenue composition	X	X		
	Enforcement of a comprehensive planning and budgeting process is weak (budgets are not passed on time)	X	X		
	Low compliance of audit requirement and backlog of external financial audits	X	X		
	Low commitment to address auditor's comments and suggestions including regularization, realization and settlement of unsettled accounts	X	X	X	X
II) PROCUREMENT RISKS					
i) Legislative and Policy Framework					
	Raising of threshold from rupees 3.5 million to rupees 6.0 million for procurement of works to be implemented by community user groups excludes professional contractors and exposes projects to low skilled and inexperienced community users groups.	X	X	X	X
	Procurement under exceptional circumstances, as allowed by PPA, can be widely used to bypass normal procedures: can be applied to expedite project works when budgets are passed towards the end of the fiscal year	X	X		
ii) Institutional Framework and Capacity					
	Low experience and skills of procurement personnel charged with ensuring	X	X		

	that the procurement law, policies, and procedures are enforced.				
	Procurement is not acknowledged as a profession and specialized personnel are not inducted.	X	X	X	X
	Procurement plans (PP) are not prepared for use in budget formulation: procurement is not guided by specific procurement manuals.	X	X	X	X
	Procurement is not integrated with financial management, and safeguards to ensure budget adequacy are absent. Absence of a Procurement Management and Information System (PMIS).	X	X	X	X
iii) Procurement Operations					
	Nominal consultation with key stakeholders in defining needs, prioritizing projects, developing technical specifications, terms of reference, or in oversight, monitoring and evaluation.	X	X		
	Selection and appointment are primarily based on lowest bid criteria: assessment of bidders' capacity and ability to complete works under the proposed budget are overlooked.	X	X		
	Disbursements are affected by political influence/interference and conflict of interest.	X	X	X	X
	No systems for quality control and performance evaluation for procurement works: Eg. Absence of performance audit	X	X	X	X

iv) Integrity of Public Procurement					
	Regulating line agencies, PPMO and municipality councils do not exercise sufficient rigor to promote procurement integrity and combat corruption.	X	X	X	X
	Mechanisms to monitor implementation and performance, including efficient and reliable communication systems for timely reporting of procurement actions/status and instilling the culture of regular reporting is not effective.	X	X		
	Collusion is rampant and threats, intimidation, and extortions are common practices	X	X	X	X
v) Public perceptions					
	Bribes and corruption are accepted and taken for granted by the society	X	X	X	X
III) CORRUPTION RISKS					
i) Political & Legislative framework					
	Absence of Municipality Council, comprising elected representatives and nominated members in accordance with the LSGA, has reduced downward accountability and diluted people's voice in municipalities' governance.	X	X		
	Prevalence of conflict of interest among political/ elected representatives and executive officers appointed by MLD.	X	X		
ii) Integrity institutions and systems					
	Absence of specific authority/commission for services in municipalities to ensure effective integrity in recruitment and appointments	X	X		
	CIAA presence at the				

	district level is limited to deputation of legal officer in some District Administration Offices. No institutional presence at the local level.	X	X	X	X
	The accountability of the district administration office is inclined more towards the Ministry of home affairs than the CIAA	X	X		
	Low capacity of the district administration office in the investigation of corruption cases	X	X	X	X
iii) Rule of Law					
	Weak enforcement of laws and regulations at the micro and macro level	X	X	X	X
v) Voice & Accountability					
	Lack of coordination and partnership amongst government, private sector and civil society in combating corruption.	X	X		
vi) Public Perceptions					
	Culture of reporting corruption cases and complaining against irregularities by the civil society is low with the tendency of accepting petty corruption as a mean to get one's work done engrained in the people's mindset.	X	X	X	X
	Law enforcement agencies are perceived to be corrupt.	X	X	X	X
B) ADB SYSTEMS					
	Risk Identified	Likely	Relatively Serious	Not Mitigated over the CPS Period	Major Risk
I) FINANCIAL MANAGEMENT RISKS					
	Disbursements to ADB projects are adversely affected by late budget allocations to the sectoral agencies	X	X		

	Ensuring local counterparts (municipalities and community based users groups) contribution in line with project financing plan is difficult and there are disbursement delays on the part of the counterparts at the local level.	X	X	X	X
	Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users' groups.	X	X	X	X
	The actual revenue generation from sub-projects does not match revenue projections adversely affecting financial sustainability and loan repayments.	X	X	X	X
II) PROCUREMENT RISKS					
	Collusion, bid-rigging and cartelism in procurement of goods, works and services is prevalent	X	X	X	X
	Lack of contractor performance oversight, weak monitoring and evaluation by community users' groups and municipalities' officials lead to acceptance of substandard construction and/or the use of inferior materials that do not meet design specification.	X	X	X	X
III) CORRUPTION RISKS					
	Political interference, conflicts of interest and nepotism in user groups selection	X	X	X	X
	MLD, MPPW and Municipalities do not have an effective anti-corruption strategy or action plan	X	X	X	X

C) CLIMATE CHANGE					
	Climate change considerations are overlooked in project planning; implementation of effects mitigation and monitoring programs; and contingency planning.	X	X	X	X
	Urban authorities, project proponents and EIA administrators lack the capacity and critical guidance on how to assess both climate change mitigation and adaptation issues	X	X	X	X
	Inter sectoral coordination and collaboration are largely missing and not incorporated into inter sectoral policies, strategies, and programs	X	X	X	X

7.0 RISK MANAGEMENT PLAN

134. To mitigate the major risks carried forward from the summary risk matrix, a risk management plan has been formulated. The major risks have been clustered under similar type of actions that can administered to address them and are placed in order of priority in descending order. The risk management plan is presented hereunder:

I) COUNTRY SYSTEMS		
A) FINANCIAL MANAGEMENT RISKS		
Major Risks	ADB Actions	Indicators
Cluster I) Technical assistance for capacity building of municipalities		
1) The institutional capacity of municipalities to manage their finance, in terms of professional human resource and accounting system, is low.	Build institutional capacity of municipalities through capacity building and upgrading existing financial management systems.	Capacity building action plans are in place Accomplishment of targeted capacity building programs Noticeable improvement in financial management
2) High dependence on government grants and Local Development Fee	Support municipalities to develop strategic business plans. Support municipalities to enhance tax base assessments Support the preparation of phase out plan of local development fee with alternative source of revenue in consultation with municipalities	Strategic business plan are in place. Tax base assessments are done and revenue from taxes is increased. Phase out plan is in place and applied Revenue generated from own source is increased and alternative arrangement in lieu of the local development fee is in place and applied.
3) Ineffective internal controls, audit, monitoring and evaluation systems	Support municipalities in strengthening internal audit and monitoring and evaluation systems	Internal audits are regular. Effective monitoring and evaluation systems are in place and applied.
4) Unrealistic budget based on programs to appease key stakeholders with optimistic revenue forecast to match expenditure budget	Support municipalities in budget formulation in consultation with stakeholders, in alignment with periodic plans and revenue forecast prepared by revenue section of municipalities.	Periodic plans are in place Budgets are in alignment with revenue forecast
Cluster II) Advocacy and lobby for policy and regulatory reforms		
1) Low commitment to address auditor's comments and suggestions including regularization, realization and settlement of unsettled accounts.	Advocate that MC & PM applied for government grants ensure the incorporation of these issues.	MC & PM are in place and complied. Settlement of unsettled accounts are as targeted
B) PROCUREMENT RISKS		
Cluster I) Technical assistance for capacity building of municipalities		
1) Procurement is not integrated with financial management, and safeguards to ensure budget adequacy are absent. Absence of a Procurement Management and Information System (PMIS).	Enable municipalities to develop and implement a PMIS, which is integrated with municipalities' management information system to coordinate financial management, budgeting and procurement.	PMIS is in place and is coordinated with municipalities' management information system.
2) No systems for quality control and performance evaluation for procurement works: Eg.	Train relevant officials in quality control and performance evaluation for procurement	There is improvement in the quality of goods, works and services procured

Absence of performance audit	Ensure that performance audit is a precondition for ADB projects in municipalities	Performance audits are in place and complied
Cluster II) Advocacy and lobby, including workshops and seminars, along with provision of relevant technical assistance for policy and regulatory reforms		
1) Bribes and corruption are accepted and taken for granted by the society	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns	There is significant increase in the number of anti-corruption campaigns and civil society organizations engaged in anti corruption campaigns
2) Regulating line agencies, PPMO and municipality councils do not exercise sufficient rigor to promote procurement integrity and combat corruption	<p>Implementing line agencies develop and implement relevant action plans and implement codes of ethics and integrity to be ratified by EAs and municipalities.</p> <p>Ensure that municipalities establish a database of contractors with qualifications, technical expertise and history of performance.</p> <p>Support the formulation of communication strategy to ensure that the public is informed of all processes and financial disclosures of municipalities and its projects.</p> <p>Ensure that contractors found guilty of corruption are black listed, debarred or disqualified</p>	<p>Relevant action plans and codes of ethics and integrity are in place and complied.</p> <p>Database is created and updated</p> <p>Strategy is formulated and applied and the level of awareness of user groups and the general public is enhanced.</p> <p>Blacklist is created and made public.</p>
3) Disbursements are influenced by political influence/interference and conflict of interest.	Set up a committee comprising CDO, Local Development Officer (LDO), municipality executive officer, representatives from user group and concerned procurement official to decide on payments on procurement that does not comply with requirements.	The Committee is in place and functional.
Cluster (III) Technical assistance for capacity building, along with relevant lobby and advocacy support, for policy and regulatory reforms		
1) Procurement is not acknowledged as a profession and specialized personnel are not inducted.	<p>Support the creation of specialized "procurement official" job classification in big municipalities (sub metropolitan and metropolitan cities).</p> <p>Provide regular and expanded training to officials responsible for procurement functions and members of procurement committee.</p> <p>Establish and implement professional qualification and certification.</p>	<p>Procurement official is in place</p> <p>Regular trainings are conducted and trainees are certified and accredited.</p>
2) Procurement plans (PP) are not prepared for use in budget formulation: procurement is not guided by specific procurement manuals.	Provide support to develop capacity of municipalities to prepare PP and manuals and ensure that PP is part of MC & PM.	PP and manuals are in place within planned time frame. Compliance of MC & PM
3) Collusion is rampant and threats, intimidation, and	Bidding in multiple places (two or more) and introduction of e-	Multiple place bidding and e-bidding are in place and practiced

extortions are common practices	bidding system. Support FCAN to familiarize contractors on e-bidding and to develop simple instruction manual	The targeted familiarization programs are carried out Instruction manual is formulated
4) Raising of threshold from rupees 3.5 million to rupees 6.0 million for procurement of works to be implemented by community user groups excludes professional contractors and exposes projects to low skilled and inexperienced community users groups.	Support amendment of Public Procurement Regulation (PPR) so that the threshold is lowered to prior level. Support capacity development of users groups to monitor construction works Allocate budget for utilization of external technical or specialized human resource for construction works by user groups.	PPR is amended and enforced. Monitoring by user groups increases and is more effective. External technical and specialized human resources are utilized for construction works and noticeable improvement in quality of construction works.
C) CORRUPTION RISKS		
Cluster I) Technical assistance for capacity building of regulating agencies		
1) Low capacity of the district administration office (DAO) in the investigation of corruption cases	Provide resources for capacity-building of DAO in prevention and investigation of corruption	The targeted numbers of capacity building programs are completed. The capacity of DAO in prevention and investigation of corruption is enhanced
2) Weak enforcement of laws and regulations at the micro and macro level	Provide resources and capacity-building support to CIAA in the three areas: enforcement, prevention and public education Assist the CIAA to establish a closer working relationship with the media	There is notable improvement in enforcement of laws and regulation at micro and macro level
Cluster II) Advocacy and lobby along with provision of relevant technical assistance for policy and regulatory reforms		
1) CIAA presence at the district level is limited to deputation of legal officer in some District Administration Offices. No institutional presence at the local level.	Lobby and support the establishment of CIAA offices at the regional level Lobby and support for permanent staff at the CIAA	CIAA offices established at the regional level Relevant laws are amended
2) Culture of reporting corruption cases and complaining against irregularities by the civil society is low with the tendency of accepting petty corruption as a mean to get one's work done engrained in the people's mindset.	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns	There is significant increase in the number of reports against irregularities
3) Law enforcement agencies are perceived to be corrupt.	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns	There is significant increase in the number of reports against irregularities
II) ADB SYSTEMS		
A) FINANCIAL MANAGEMENT RISKS		
Cluster (I) Technical assistance for capacity building along with relevant lobby and advocacy support for policy and regulatory reforms		
1) Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users' groups.	Develop monitoring mechanism to ensure that disbursements are made on time by the TDF and other responsible agencies. Establish quarterly and/or as and when necessary interaction	Timely disbursements are made Reduced project level disputes among local level stakeholders

	amidst user groups, civil society and representatives of political parties. Support capacity development of leaders and office bearers of user groups.	and stoppage of implementation works Improved capacity of user groups leaders in monitoring and financial management.
2) The actual revenue generation from sub-projects does not match revenue projections adversely affecting financial sustainability and loan repayments.	Exercise more rigor on the conduction of project viability and appraisal, especially taking ground realities into consideration. Focus on increasing interaction and involvement of TDF appraisal team with consultants given the responsibility of project design and techno-economic feasibility study. Focus on programs that raise community awareness on issues related to project sustainability.	Revenue generation does not significantly deviate from projections. Community members understand and accept tariff structures.
3) Ensuring local counterparts (municipalities and community based users groups) contribution in line with project financing plan is difficult and there are disbursement delays on the part of the counterparts at the local level.	Ensure that the required portion of counterparts fund is expended together with ADB funds through disbursement only after counterparts' contribution is transferred to the prescribed account or contribution in kind is matched as planned.	Counterpart funds are disbursed as per schedule.
B) PROCUREMENT RISKS		
Cluster (I) Technical assistance for capacity building along with relevant lobby and advocacy support for policy and regulatory reforms		
1) Collusion, bid-rigging and cartelism in procurement of goods, works and services are prevalent.	Built up capacity of evaluation committee members to conduct more informed and rigorous due diligence in bid evaluation Disqualify and blacklist contractors that are found guilty of corrupt practices, or which have a history of poor performance	The quality of bid evaluation is enhanced. Blacklisted and disbarred contractors are not allowed to bid in any public entity and blacklisting is made available to the public
2) Lack of contractor performance oversight, weak monitoring and evaluation by community users' groups and municipalities' officials lead to acceptance of substandard construction and/or the use of inferior materials that do not meet design specification.	Support municipalities to develop and apply effective monitoring systems Conduct mid term and final technical audits before acceptance of end product Establish annual public audit systems	Monitoring systems applied and effective Mid term and final technical audits applied Annual public audit system is institutionalized Complains regarding substandard use of materials are reduced.
C) CORRUPTION RISKS		
Cluster I) Advocacy and lobby with provision of relevant technical assistance by ADB for policy and regulatory reforms		
1) Executing and implementing agencies do not have an effective anti-corruption strategy or action plan	Support GoN for the preparation of an anti-corruption strategy and action plan for ministries/line agencies and local bodies	Anti-corruption strategy and action plan are in place and complied. Decrease in level of corruption
2) Political interference, conflicts	Support MLD for the preparation	Guideline is prepared and

of interest and nepotism in user groups selection	for UG selection criteria	complied UG selection demonstrates greater transparent process
D) CLIMATE CHANGE RISKS		
Cluster (I) Technical assistance for capacity building of urban authorities		
1) Urban authorities, project proponents and EIA administrators lack the capacity and critical guidance on how to assess both climate change mitigation and adaptation issues	Support capacity building of key institutions involved in urban development at national and local level, and within vulnerable sectors or population groups	Climate change risk management becomes a operational activity undertaken by key institutions responsible for designing and building infrastructure in vulnerable areas.
Cluster II) Advocacy and lobby, including seminar and workshops, with provision of relevant technical assistance for policy and regulatory reforms		
1) Climate change considerations are overlooked in project planning; implementation of effects mitigation and monitoring programs; and contingency planning.	Help devise and support massive information campaign to: i) disseminate information on actual climate changes and future trends ii) highlight and articulate climate-risk management priorities and the role of communities, civil society and NGOs in managing climate change risks at the local level	Key stakeholders acknowledge and are aware of climate change issues Preventive actions are taken to adapt to climate change and reduce disaster risks
2) Inter sectoral coordination and collaboration are largely missing and not incorporated into inter sectoral policies, strategies, and programs	Support sectoral policies, strategies, and programs formulation to address the consequences of climate change and climate variability to economic development need and strengthen inter-agency and inter-sector collaboration	Sectoral policies, strategies, and programs formulation are formulated. Inter-agency and inter-sector collaboration take place

135. To support the risk management plan, a summary of priority risks and mitigation and/or management measures that can be taken by ADB are depicted below:

S.N.	Major Risks	ADB Actions for Mitigation/Management
(A) Public Financial Management		
01.	The institutional capacity of municipalities to manage their finance, in terms of professional human resource and accounting system, is low; and there is ineffective internal controls, audit, monitoring and evaluation systems along with high dependence on government grants and Local Development Fee.	Technical assistance for: i) institutional capacity building of municipalities to upgrade existing financial management systems, develop strategic business plans, and enhance tax base assessments; ii) strengthening internal audit and monitoring and evaluation systems; and iii) preparation of phase out plan of local development fee , with alternative source of revenue, in conjunction with MuAN and MLD and in consultation with all municipalities.
02.	Low commitment to address auditor's	Advocate that MC & PM applied for government

	comments and suggestions including regularization, realization and settlement of unsettled accounts.	grants ensure the incorporation of these issues.
03.	Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users' groups.	<p>Develop monitoring mechanism in ADB projects to ensure that disbursements are made on time by the TDF and other responsible agencies.</p> <p>Establish quarterly and/or as and when necessary interaction amidst user groups, civil society and representatives of political parties in ADB projects.</p> <p>Support capacity development of leaders and office bearers of user groups.</p>
(B) Procurement		
01.	Procurement is not integrated with financial management and there is absence of safeguards to ensure budget adequacy, Procurement Management and Information System (PMIS) and quality control and performance evaluation for procurement works: Eg. Absence of performance audit	<p>Technical assistance to: i) enable municipalities to develop and implement a PMIS, which is integrated with municipalities' management information system to coordinate financial management, budgeting and procurement; and train relevant officials in quality control and performance evaluation for procurement</p> <p>Ensure that performance audit is a precondition for ADB projects in municipalities</p>
02.	Bribes and corruption are accepted and taken for granted by the society	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns
03	Collusion is rampant and threats, intimidation, and extortions are common practices	<p>Lobby and advocate for bidding in multiple places (two or more) and introduction of e-bidding system.</p> <p>Support FCAN to familiarize contractors on e-bidding and to develop simple instruction manual</p>
04	Procurement plans (PP) are not prepared for use in budget formulation and procurement is not guided by specific procurement manuals.	Provide technical assistance to develop capacity of municipalities to prepare PP and manuals and advocate to ensure that PP is part of MC & PM.
(C) Corruption		
01.	Executing and implementing agencies do not have an effective anti-corruption strategy or action plan.	Provide technical support GoN for the preparation of an anti-corruption strategy and action plan for ministries/line agencies and local bodies
02.	CIAA presence at the district level is limited to deputation of legal officer in some District Administration Offices. No institutional presence at the local level.	<p>Lobby and support the establishment of CIAA offices at the regional level</p> <p>Lobby and support for permanent staff at the CIAA</p>
03.	Culture of reporting corruption cases and complaining against irregularities by the civil society is low with the tendency of accepting petty corruption as a mean to get one's work done engrained in the people's mindset and) law enforcement agencies are perceived to be corrupt	Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns

(D) Climate Change		
01.	<p>Urban authorities, project proponents and EIA administrators lack the capacity and critical guidance on how to assess both climate change mitigation and adaptation issues and thus climate change considerations are overlooked in project planning; implementation of effects mitigation and monitoring programs; and contingency planning.</p>	<p>Help devise and support massive information campaign to: i) disseminate information on actual climate changes and future trends ii) highlight and articulate climate-risk management priorities and the role of communities, civil society and NGOs in managing climate change risks at the local level</p> <p>Support sectoral policies, strategies, and programs formulation to address the consequences of climate change and climate variability to economic development need and strengthen inter-agency and inter-sector collaboration</p>

ANNEX- I

LIST OF PERSONS CONSULTED

S.N.	Organization	Name	Designation
01	Asian Development Bank (ADB)	Mr. Terry N. Woods Mr. Narendra Chand Mr. Komal Pandey Ms. Laxmi Sharma Mr. Arun Rana	Senior Procurement Specialist Procurement Officer Project Implementation Officer Project Officer Consultant
02	World Bank (WB)	Mr. Kiran R. Baral Mr. Bigyan Pradhan	Senior Procurement Specialist Senior Financial Management Specialist
03	Ministry of Local Development (MLD)	Mr. Jeevan K. Shrestha Mr. Narayan Thapa Mr. Bishnu Gauli Mr. Dhurba Dahal	Senior Divisional Engineer Under Secretary Under Secretary Under Secretary
04	Secretariat of Local Bodies Fiscal Commission, MLD	Mr. Badri N. Ghimire Mr. Purusottam Nepal	Under Secretary Under Secretary
05	National Vigilance Center	Mr. Kedar M. Prajapati	Senior Divisional Engineer
06	Federation of Contractors' Associations of Nepal (FCAN), Kathmandu	Mr. Yagya B. Karki Mr. Sharad K. Gauchan Mr. Basu Dev Upreti	President General Secretary Deputy General Secretary
07	Department for International Development (DFID)	Mr. Chandra B. Shrestha Mr. Sishir Bhattarai	Infrastructure Advisor Public Financial Management Adviser
08	FCAN, Biratnagar	Mr. Ramesh K. Dahal Mr. Dipendra Karki Mr. Lekhnath Khatri Mr. Sagar Baniya Mr. Kumar Pokharel Mr. Ramesh Koirala Mr. Kedar Parajuli Mr. Alok K. Basnyet Mr. Raj K. Karki Mr. Rajesh Giri Mr. Indra P. Bartaula	President Ex - president Vice President Member Member Member Member Member Member Member Member Member
09	Biratnagar Sub Metropolitan City Office	Mr. Dilip K. Chapagain Mr. Sanjeev Bhattarai Mr. K. Thapoliya	Executive Officer Chief, Finance Section Chief, Revenue Section
10	District Administration Office, Morang, Biratnagar	Mr. Shashi S. Shrestha	Chief District Officer
11	Public Procurement Monitoring Office (PPMO)	Mr. Suresh Pradhan	Director
12	Commission for the Investigation of Abuse of Authority (CIAA)	Mr. Ishwori P. Poudyal	Joint Secretary and Spokesperson
13	Auditor General's Office	Mr. Bhadreshwor P. Upadhya	Acting Auditor General (AG)

		Mr. Badri B. Karki Mr. Mahadutta Timsina Mr. Dev B. Bohara	Deputy AG Assistant AG Assistant AG
14	Ministry of Finance	Mr. Abi Nath Rai	Under Secretary
15	District Development Committee(DDC), Bhaktapur	Ms. Uma Pandey	Local Development Officer (LDO)
16	Bhaktapur Municipality	Mr. Hari Lochan Sharma Ms. Ratna Maya Shrestha Ms. Roshana Neuche Mr. Ganesh Fujju	Executive Officer Chief, Financial Administration Section Planning Section Legal Officer
17	Municipality Association of Nepal (MuAN)	Mr. Sushil Gyewali Mr. Ramesh Shrestha Mr. Kalamdhi Devkota	President Program Officer Ast. Executive Secretary
18	Lalitpur Sub-Metropolitan City Office	Mr. Binod P. Singh Ms. Surya Tamrakar Mr. Pravin Shrestha Ms. Indira Bhandari Mr. Shreebhadra Ojha	Executive Officer Account Officer Chief, Urban Dev. & Public Work Div. Planning Section Chief, Store Section
19	PEFA Secretariat	Mr. Dev Raj Pathak	Joint Financial Comptroller & Coordinator PEFA Secretariat
20	Financial Comptroller General's Office	Mr. Arvind Shrestha	Financial Comptroller General
21	Nepalganj Municipality Office	Mr. Ram Lal Shrestha Mr. Rajan K.C Mr. Karna KK Ms. Rita Chaudhary Dr. Rajendra Gupta	Executive Office Chief, Account Section Chief, Planning Section Social Mobilizer, RUPP Section Representative of All Party Advisory Board
22.	District Administration Office, Banke, Nepalganj	Mr. Ganesh Bdr. Khatri	Chief District Officer
23.	Kathmandu Metropolitan City Office	Mr. Narayan Gopal Malegu Mr. Devendra Dangol	Executive Officer Chief, Public Construction and Physical Development Division
24.	Ministry of Physical Planning and Works	Mr. Komal Raj Pnadey	Joint Secretary
25.	Department of Urban Development and Building Construction	Mr. Purusottam Dangol Mr. Om B. Rajopadhya	Acting Director General Deputy Director General & Executive Director, TDF
26.	German Technical Cooperation (GTZ), Urban Development Through Local Efforts (UDLE)	Dr. Horst Matthaeus Mr. Laxman G. Rajbhandari Mr. Ram B. Chhetri	Program Manager Management Consultant Urban Finance Advisor
27.	Town Development Fund (TDF)	Mr. Shiva Shrestha Mr. Rajesh K. Bhochohibhoya Mr.Hera Kaji Maharjan	Assistant Manager Civil Engineer Civil Engineer

		Mr. Subas Raj Panta	Socio Economist
28.	Department of Water Supply and Sanitation (DWSS)	Mr. Tires Khatri	Deputy Project Manager Small Towns Water Supply and Sanitation Sector Project
29.	United Nations Development Program (UNDP) United Nations Capital Development Fund (UNCDF)	Mr. Sharad Neupane Ms. Alexendra Walcher	Assistant Resident Representative, Governance Unit Program Officer
30.	Canadian Embassy to Nepal C/o Canadian Cooperation Office	Mr. Ed Joe	Counselor (Development) & Counsel CIDA Head of Aid-Nepal
31.	Bidur Municipality	Mr. Mitha Ram Humagain Mr. Keshab B. Shrestha	Executive Officer Accountant
32.	Urban Environment Improvement Project, Bidur, Nuwakot	Mr. Milan Acharya Mr. Bishnu K. Chitrakar Mr. Krishna C. Jha	Project Manager Accountant Consultant
33.	District Administration Office, Nuwakot	Mr. Abdul Kalam Khan Mr. Jagadishwor Dahal	Chief District Officer Account
34.	Central Department of Economics, Tribhuvan University	Dr. Bishwomber Pyakurel	Professor Director, Nepal Rastra Bank

ANNEX- II

LIST OF DOCUMENTS REVIEWED

- Report and Recommendation of the President to the Board of Directors, Proposed Program Cluster and Grant for Subprogram 1, Federal Democratic Republic of Nepal: Governance Support Program, Project Number: 36172, Asian Development Bank, October 2008
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