Risk Assessment and Risk Management Plan: Water Supply and Other Municipal Infrastructure Service

Nepal
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
MoFALD  Ministry of Federal Affairs and Local Development
MoF  Ministry of Finance
MoUD  Ministry of Urban Development
MPPW  Ministry of Physical Planning and Works
MuAN  Municipalities Association of Nepal
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>NCB</td>
<td>National Competitive Bidding</td>
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<td>NGO</td>
<td>Non-government Organization</td>
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<td>NPC</td>
<td>National Planning Commission</td>
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<td>NVC</td>
<td>National Vigilance Center</td>
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<td>OED</td>
<td>Operations Evaluation Department</td>
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<td>PCO</td>
<td>Project Coordination Office</td>
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<td>PEFA</td>
<td>Public Expenditure and Financial Accountability</td>
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<td>PFM</td>
<td>Public Financial Management</td>
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<td>PIU</td>
<td>Project Implementation Unit</td>
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<td>PMO</td>
<td>Project Management Office</td>
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<td>PPP</td>
<td>Public-Private Partnership</td>
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<td>PPPUE</td>
<td>Public-Private Partnership for the Urban Environment</td>
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<td>PPR</td>
<td>Public Procurement Regulations</td>
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<td>PRS</td>
<td>Poverty Reduction Strategy</td>
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<td>RBN</td>
<td>Road Board Nepal</td>
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<td>RPM</td>
<td>Risk Management Plan</td>
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<td>RSDD</td>
<td>Regional and Sustainable Development Department</td>
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<td>SDC</td>
<td>Swiss Agency for Development and Cooperation</td>
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<td>SOE</td>
<td>Statement-of-expenditure</td>
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<td>SWAp</td>
<td>Sector Wide Approach</td>
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<td>TDCs</td>
<td>Town Development Committees</td>
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<td>TDF</td>
<td>Town Development Fund</td>
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<td>TYIP</td>
<td>Three Year Interim Plan</td>
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<td>UDLE</td>
<td>Urban Development through Local Efforts</td>
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<td>UEIP</td>
<td>Urban Environmental Improvement Project</td>
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<td>UG</td>
<td>User Group</td>
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<tr>
<td>UNDAF</td>
<td>United Nations Development Assistance Framework</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>VDC</td>
<td>Village Development Committee</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
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<td>WFP</td>
<td>World Food Programme</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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<td>WUSC</td>
<td>Water Users and Sanitation Committee</td>
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I. INTRODUCTION

1. 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.

2. 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.

3. 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.

4. 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.

5. 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.
6. 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:

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

7. 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.

8. 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.

9. 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:

<table>
<thead>
<tr>
<th>Major Risks</th>
<th>ADB Actions for Mitigation/Management</th>
</tr>
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<tbody>
<tr>
<td><strong>Public Financial Management</strong></td>
<td>Technical assistance for: i) institutional capacity building of municipalities to upgrade existing financial management systems; ii) developing strategic business plans, and enhance tax base assessments; and</td>
</tr>
<tr>
<td>Low commitment to address auditor's comments and suggestions including regularization, realization and settlement of unsettled accounts.</td>
<td>Advocate that MC &amp; PM applied for government grants ensure the incorporation of these issues.</td>
</tr>
<tr>
<td>Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users’ groups.</td>
<td>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.</td>
</tr>
<tr>
<td><strong>Procurement</strong></td>
<td></td>
</tr>
<tr>
<td>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</td>
<td>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.</td>
</tr>
<tr>
<td>Bribes and corruption are accepted and taken for granted by the society</td>
<td>Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns.</td>
</tr>
<tr>
<td>Collusion is rampant and threats, intimidation, and extortions are common practices</td>
<td>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.</td>
</tr>
<tr>
<td>Procurement plans (PP) are not prepared for use in budget formulation and procurement is not guided by specific procurement manuals.</td>
<td>Provide technical assistance to develop capacity of municipalities to prepare PP and manuals and advocate to ensure that PP is part of MC &amp; PM.</td>
</tr>
<tr>
<td><strong>Corruption</strong></td>
<td></td>
</tr>
<tr>
<td>Executing and implementing agencies do not have an effective anti-corruption strategy or action plan.</td>
<td>Provide technical support GoN for the preparation of an anti-corruption strategy and action plan for ministries/line agencies and local bodies.</td>
</tr>
<tr>
<td>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.</td>
<td>Lobby and support the establishment of CIAA offices at the regional level. Lobby and support for permanent staff at the CIAA.</td>
</tr>
<tr>
<td>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</td>
<td>Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns.</td>
</tr>
</tbody>
</table>
II. CONTEXT

10. Nepal, which 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 position\(^1\) 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 infrastructure\(^2\) challenged municipalities' capacities and ability to perform.

11. According to the Central Bureau of Statistics (CBS), 2011, the urban population comprised about 17 percent of the total population of Nepal. 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\(^3\) Thereafter, the migration of rural people to urban areas appears to have increased. 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. The CBS population projection is presented in the table below.

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2006</th>
<th>2011</th>
<th>2016</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total population</td>
<td>23151423</td>
<td>25,886,736</td>
<td>26494504</td>
<td>28401780</td>
<td>30446357</td>
</tr>
<tr>
<td>Urban population</td>
<td>3227879</td>
<td>4,322,996</td>
<td>4523820</td>
<td>7,156,789</td>
<td>9,047,244</td>
</tr>
<tr>
<td>Urban population in %</td>
<td>14.2</td>
<td>16.70</td>
<td>17.1</td>
<td>22.85</td>
<td>26.48</td>
</tr>
<tr>
<td>Annual Growth rate in %</td>
<td>5.77</td>
<td>5.17</td>
<td>4.91</td>
<td>4.69</td>
<td></td>
</tr>
</tbody>
</table>


12. 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, 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.

13. 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

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\(^1\) 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.

\(^2\) 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.

\(^3\) As cited in the Three Year Interim Plan (2008 - 10)
(VDCs) within a new municipal administration. They are characterized by poor governance, inadequate basic infrastructure and low internal revenue generation making them largely dependent on government grants.

14. 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.

A. Constraints

15. 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 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.

16. 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.

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

18. 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

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4 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.
5 As explained earlier, many municipalities were established by lumping together a number of VDCs with thin population density spread across large rural agriculture areas.
6 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.
also hampered by frequent changes in the executive officers who are appointed by the GoN. Urban development is also hindered by the lack of coordination within, and among relevant line agencies, donor agencies, and municipalities.

19. 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.

<table>
<thead>
<tr>
<th>Box - 1: Problems Related to Local Bodies</th>
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<tbody>
<tr>
<td>• Low institutional capacity and lack of capacity enhancement of human resource.</td>
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<tr>
<td>• Lack of timely reconstruction of infrastructure destroyed during the conflict.</td>
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<tr>
<td>• 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.</td>
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<tr>
<td>• Lack of institutions to control corruption and compliance to fiscal discipline in local bodies.</td>
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<td>• Lack of timely and quality execution of development works owing to the absence of required technical support.</td>
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<td>• Excessive work burden on the personnel deputed in local bodies.</td>
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</tbody>
</table>

III. DESCRIPTION OF THE SECTOR

A. Sector history and focus

20. 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.

21. 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.

22. 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

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Executive Officers of local bodies are usually changed when a Minister from a different political party takes charge of the Ministry of Local Development.
to municipalities) were some of the major reforms witnessed in this period.

23. 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.

24. 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.

B. Legal framework and institutional arrangements

25. 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. Currently there are 58 municipalities which are divided into a minimum of nine wards with the maximum depending on the population, geographical coverage, level of urban services, and income. 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 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. There are however no elected representatives in local bodies since 2002 and in their absence, local bodies are headed by civil servants (Local Development Officer in DDC, Executive Officer in Municipality, and Secretary in VDC) deputed from the center.

26. 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. The LSGA has made the ward committees responsible for managing the wastewater within their respective areas. The functions, duties and powers of each Ward Committee (Section 25) under the Village Development Committee include keeping roads, lanes, bridges, drainage, ponds, lakes, wells, deep water, taps, etc. within the Ward neat and clean and making arrangements for disposal of wastes, dirt and rotten materials, and encouraging the inhabitants for maintaining sanitation. The functions, duties and powers of each Ward Committee under the Municipality (Section 93) include keeping the roads, ways, bridges, drainage, ponds, lakes, wells, deep water, stone water taps, temples, shrines, monasteries, public place etc. within the Ward neat and clean, and

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

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

10 Areas that cover a cluster of VDCs and municipalities.
arranging for disposal of wastes, dirt, rotten materials and for keeping the streets and corners within the Ward clean, and making arrangements to encourage the inhabitants of the Ward for maintaining sanitation. In addition to executing the decisions and directions of the Municipal Council, the functions and duties to be performed by the Municipality (Section 96) includes to assist, or be assisted, in environment protection acts by controlling water, air and noise pollution generated in the Municipality area.

27. 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.

28. Nepal had no specific urban policy with successive Five-year Plans and sector specific policies guiding the urbanization process and enhancing urban-rural linkages till 2007, when the government of Nepal 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)\textsuperscript{11} for all wards.

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 is the government's response to the severe lack of access to water supply and sanitation services in Nepal's urban areas. 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.

30. The National Water Plan 2005 has only mentioned about the sanitation which is tied up with water supply. As plan for rural sanitation, it has aimed to provide basic sanitation to households by constructing latrines in rural areas after providing them capital subsidy to do so. The plan has expected that the awareness will gradually increase and the people will undertake construction of latrines themselves in due course. However it has failed to emphasize the management of wastewater.

31. The plan has recognized that the investment need for urban sewerage and wastewater treatment is greater than that for urban water supply. The existing level of service being offered in sanitation is either very poor or non-existent as the existing systems cannot deal with the volume of wastewater that is being generated. Hence, quality drainage and wastewater treatment facilities are needed. Prior to setting up the necessary infrastructure and management systems, a mechanism for full cost recovery of O and M has to be implemented. One way of accomplishing this is to include such a mechanism in water tariffs. The tariffs for industrial users should be directly related to the cost of providing the required quality of service and wastewater

\textsuperscript{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.
treatment. There is also a need for effluent standards enforcement and a revision of the tariff structure for industrial consumers.

32. Environment Protection Act 2053 (1996) and the Regulation. In the process of internalizing the Environmental Assessment System in development proposals, the government of Nepal enacted the Environment Protection Act (EPA) 1997 and the Environment Protection Rules (EPR) 1997, which makes the integration of IEE and EIA legally binding to the prescribed projects. Proposals requiring IEE and EIA study are included in Schedules 1 and 2 of the EPR, 1997 respectively. The EPA, 1997 obliges the proponent to prepare IEE or EIA report on the prescribed proposals. Implementation of such proposals is carried out after the approval of EIA by concerned agency (sectoral ministry) and Ministry of Environment. The Act outlines the process for the submission of the proposal by the proponent and approval of reports through the concerning authority. The EPR, 1997 elaborates provisions to prepare and submit the scoping report, Terms of Reference (TOR), and IEE/EIA report for approval and includes public consultation processes. As per the EPR 1997, the EA report, in general, should include detail information on impacts and environmental protection measures, including implementation plan, monitoring and evaluation and environmental auditing.

33. Promoter of any industry is required (Section 3) to carry out Initial Environmental examination (IEE) or Environmental Impact Assessment (EIA) of the proposed industry considering the size of industry and its effect in environment. The promoter is also required to prepare a proposal for examining or assessing the impact on environment by establishment of an industry. Only after approval of the proposal (Section 6) IEE or EIA should be conducted and industry should be established with a plan to mitigate any adverse effect or impact in environment. The Act (Section 7) has prohibited to create pollution as to cause significant adverse impacts on the environment or likely to be hazardous to public life and people’s health, or dispose or cause to be disposed sound, heat, radioactive rays and wastes from any mechanical devices, industrial enterprises, or other places contrary to the prescribed standards. The Act made provision for appointing Environment Inspector in order to effectively carry out or cause to be carried out the acts of the mitigation, avoidance or control of pollution or the acts required to be carried out in accordance with the IEE or EIA.

34. The privatization Act has been formed to increase the productivity through enhancement of efficiency of the status owned enterprise of the government to mitigate the financial administrative burden and to conduct economic development of the country by broadening the participation of private sector in the operation of private company. This regulation also recommends the programs and priorities of the privatization to the Government.

35. The Industrial Enterprise Act 2049 (1992) has made provision (Section 15) for a reduction of up to 50 percent from the taxable income for the investment of any industry on process or equipment, which has the objective of controlling pollution or which have a minimum effect on the environment as an encouragement. Such investment may be deducted on a lump-sum or on an installment basis within a period of three years. The Act also requires an industry that has impacts on environment to conduct IEE and EIA before establishing.

36. Water Supply Management Board Act 2006 places emphasis on the involvement of local bodies and institutions in the water supply and wastewater sector development in the urban areas. It allows for the establishment of autonomous and independent water supply
management boards for a municipality or a group of municipalities at local level for providing water supply and wastewater services. It also allows for involvement of the private sector in the management and operation and maintenance of the systems. In case of Kathmandu Valley, the act has made it mandatory for Kathmandu Valley Water Supply Management Board (KVWSMB) to issue license to a service provider for operation and management of its water supply and wastewater system. The Board is responsible for provision of drinking water and sanitation service in its area of jurisdiction. However, no standard of sanitation service is prescribed so far.

37. The Water Supply Tariff Fixation Commission Act 2006 provided the authority to the Water Supply Tariff Fixation Commission (WSTFC) for economic regulation of water supply and wastewater services and in resolution of consumer complaints. This autonomous corporate body is empowered to fix the tariff for water supply and wastewater services independently at a reasonable price based on level of service and the cost involved in providing the service. WSTFC shall ultimately be responsible for regulation of water supply and wastewater services throughout the country though it has initially started its activities from Kathmandu Valley. Annex 6–B, presents SWOT analysis and KUKL tariff structure.

C. Institutions and Stakeholders

38. In the early 1990s, the institutional framework for urban development was created with the establishment of the Ministry of Housing and Physical Planning, then the Ministry of Physical Planning and Works (MPPW) and now Ministry of Urban Development (MOUD), Nepal Water Supply Corporation (NWSC), Urban Development Training Centre, and town development committees in each municipality. Kathmandu Valley Water Supply Management Board (KVWSMB), Kathmandu Upatyaka Khanepani Limited (KUKL), and Water Supply Tariff Fixation Commission were formed in late 2000s as part of an institutional reform program for water supply sector in Kathmandu Valley. Kathmandu Valley Development Authority (KVDA) came into existence in 2012 for coordinated development of Kathmandu Valley.

39. Several government ministries, departments and other agencies are involved in the development of the water supply and sanitation (WSS) sector and other related activities. The MOUD is responsible for formulating national level policies and programs, and guiding sector activities to meet objectives and targets outlined in National Development Plans. The Department of Water Supply and Sewerage (DWSS) is the lead agency in the sector and is responsible for water supply services in rural areas and smaller urban centres. KVWSMB and NWSC are responsible for the development of water supply and wastewater services in larger urban centres.

40. KVWSMB, an autonomous body established under WSMB Act (2006), is responsible for the development and provision of water supply and wastewater services to inhabitants of Kathmandu Valley. As per the Act, KVWSMB owns the assets of water supply and sewerage infrastructure and delivers the services through the service operator in Kathmandu Valley. NWSC, a semi-autonomous corporation, is responsible for water supply and wastewater services in major urban centres outside of Kathmandu Valley. Separate water supply management boards have been established in some municipalities (Hetauda and Bharatpur) recently under WSMB Act of 2006 for development and management of water supply and sanitation services. MOUD oversees urban water supply and sanitation including activities of KVWSMB, KUKL, NWSC, and other WSMBs and municipalities.

41. KUKL was incorporated as a public company effective corporate management in
February 2008 as part of major institutional reforms in the Kathmandu valley water supply and sewerage sector. The shareholders are Nepal Government (30%), Kathmandu Metropolitan City (30%), Lalitpur Sub-metropolitan City (10%), Nepal chamber of commerce (15%), KUKL employees (5%) and Bhaktapur, Madhyapurthimi and Kirtipur Municipalities (10%). The overall responsibility for operation and management of all water supply and sewerage systems in the Kathmandu valley has been transferred to KUKL, which acts as a service operator. KUKL has a lease agreement with Kathmandu Valley Water Supply Management Board (KVWSMB) for the next 30 years to operate and manage including maintenance and improvements the water supply and sewerage services in the Kathmandu valley towns and surrounding areas. Good sewer network coverage, minimum sewer logging incidents and proper sewerage treatment and disposal as per master plan are some of the major goals of KUKL.

42. KVWSMB has the responsibility of supervising and guiding KUKL with the asset ownership and development. The agreement also states that i) all existing wastewater treatment plants are to be functional by February 2014, ii) wastewater is to be diverted wastewater treatment plants and each plant run to at least 90% of its hydraulic capacity, iii) wastewater services in the form of sewer or on-site sanitation should be made accessible to 90% of the population in the service area by the beginning of the fifth year after the commissioning of Melamchi Project (GON, 2008).

43. High Powered Committee for Integrated Development of the Bagmati Civilization (HPCIDBC) is created by the Government initially to clean the Bagmati River along Pashupati temple. It also carries out operation and maintenance of Guheshwori wastewater treatment plant. It is in the process of planning, developing and constructing interceptor sewers along both banks of Bagmati River. At present, the works undertaken are detailed design of interceptors and construction in some stretches of Bagmati. The Government has recently entrusted HPCIDBC with the overall responsibility to clean Bagmati River and has approved Bagmati Action Plan. The plan is a comprehensive plan for improvement of Bagmati River, its tributaries and surrounding areas.

44. Water Supply Tariff Fixation Commission (WSTFC) has authority for economic regulation of water supply and wastewater services; and in resolution of consumer complaints. The commission is established with the enactment of WSTFC Act 2006. This autonomous corporate body is empowered to fix the tariff for water supply and wastewater services independently at a reasonable price based on level of service and the cost involved in providing the service. WSTFC shall ultimately be responsible for regulation of fee/charge of water supply and wastewater services throughout the country. WSTFC has initially started its activities from Kathmandu Valley. Some stakeholders have expressed the view that the tariff fixation work should be given to KUKL subject to approval from KVWSMB or ministry of finance or National Planning Commission since it is a temporary task. Currently WSTFC office is not functional due to the budget constraint and its future has been questioned.

D. Harmonization among key stakeholders

45. Several agencies are working in the drainage and wastewater sectors in Kathmandu Valley. They include KUKL, HPCIDBC, all five Municipalities/VDCs/DDCs, Department of Roads (DoR), Department of Urban Development and Building Construction (DUDBC), Kathmandu Valley Development Authority (KVDA), I/NGOs, communities, local clubs and Users
Committees.

46. Duplication and overlapping of work occur due to unclear division of work and lack of coordination between the actors. Actors like Municipalities/VDCs/DDCs, I/NGOs, local communities and community based organizations carry out new construction or laying of sewer lines but are not involved in operation and maintenance. KUKL is responsible for operation and maintenance.

47. The municipalities are heavily investing in new sewer lines and drains through community participation program but there is lack of coordination with KUKL. This has resulted in development of sewers in a haphazard manner. Bhaktapur municipality has tried to take over sewerage system in Bhaktapur including Sallaghari WWTP in the last decade, but this has not been successful.

48. Overlapping and inconsistency in planning and development of sewerage works is found between KVWSMB/KUKL and HPCIDBC. Under its operating license from KVWSMB, KUKL has been assigned to carry out works on collection, conveyance, treatment and disposal of wastewater within municipality areas. The only other agency entrusted with responsibility for sewage collection and treatment is HPCIDBC. In addition to owning and operating Guheshwori WWTP, HPCIDBC is constructing interceptor sewers along Bagmati River.

49. The funding for operation and maintenance of facilities under HPCIDBC is not based on revenue from sewerage service provision but comes directly from the Government, reflecting the high priority placed on protection of the Bagmati River and its environs. Similarly the laying of interceptor/trunk sewer lines along Bagmati River is carried out by HPCIDBC from the funds provided by the Government. KUKL is responsible for all laterals and branch sewers which ultimately connect to the trunk sewers.

E. Institutional Structure for Water and Wastewater Sector in Kathmandu Valley

50. In order to have an efficient water and wastewater sector management institution in Kathmandu valley, GoN with the support of ADB carried out institutional reform of water sector in Kathmandu Valley as part of the Melamchi Water Supply Project initiative. The reform program included restructuring of the existing NWSC and establishing three separate entities, each for the role of asset ownership and policy setting (Kathmandu Valley Water Supply Management Board (KVWSMB), operation and management of services (Kathmandu Upatyaka Khanepani Limited (KUKL) and economic regulation of the services (Water Supply Tariff Fixation Commission (WSTFC). The new institutional arrangement has been designed to establish the legal basis for developing an institutional structure with the goal to; a) establishing a mechanism for representation of municipalities and the public at a policy level; b) protecting the operating company from political interference in management and operational decisions; c) implementing an efficient set of tariffs based on the principle of cost recovery; d) running the operating company in a professional and commercial manner, and e) introducing PSP modality to manage service delivery of operating company.

51. The new arrangement provided KVWSMB with the responsibility and the authority to develop and manage water supply and wastewater services in KV. KVWSMB issued a preparing license to KUKL and also signed asset lease agreement for 30 years. Under the license, KUKL is required to operate the services in a professional manner and achieve the following goals:
(i) regularity and continuity of water supply;
(ii) protection of public health and security through water and wastewater management;
(iii) efficiency in operations;
(iv) equity and universality of supply and service, and
(v) responsiveness to customer’s needs.

52. KUKL is also required to meet the service standard as specified in the license. Under the Asset Lease Agreement, KUKL has had exclusive use of leased assets for the purpose of providing water supply and wastewater services over 30 years and is responsible for maintaining the leased assets in good working condition, preparing capital investment and asset management programs to meet the service standards specified in the license, and implementing such investment plan as approved by KVWSMB. As a license provider, KVWSMB is also responsible for monitoring whether KUKL complies with the provisions of the operating license and asset lease agreement in providing water supply and wastewater services and resolution of consumer complaints.

53. KUKL is operating the services under the Licence issued by KVWSMB for operating Water Supply/Sanitation Services. Both KUKL and KVWSMB are required to fulfil/comply with terms and conditions of the license but have not been able to do so, mainly, i) KUKL has not fully complied with license and lease fees, ii) WSTFC tariff setting has just considered inflation but not real cost resulting in insufficient revenue. KVWSMB and Government not been able to provide subsidy to manage the differences; iv) KUKL’s inability to meet the service standards from the very beginning/first year, v) weak oversight role/monitoring from KVWSMB. In view of above, the government has to take lead to review the license provisions and resolve the differences among the stakeholders by redefining the license and roles of stakeholders, mainly with KUKL, WSTFC, KVWSMB, Ministry of Finance, Ministry of Urban Development on lease and license fee, water tariff setting, and service standards on practical and reasonable ways.

54. Figure 1-1 presents the general institutional structure for water supply and wastewater sector in Kathmandu Valley. The link between KVWSMB, KUKL and WSTFC are legal and contractual rather than hierarchical.

55. 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.

56. A similar situation also prevails in the expenditure front. Actual expenditure on major heads fell far behind compared to the projected ones.

57. 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.

F. Recent work to assess and reform PFM, procurement, and corruption in local bodies
58. 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) assessment at the local level was undertaken in 2008. 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.

59. 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.

60. 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. Besides the new Procurement Act, new legislations with anticorruption provisions have been enacted in recent years—the Promoting Market Competition Act, 2006; Right to

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12The 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."
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.

G. 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.\(^\text{13}\)

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, has been accounted for a significant portion of the municipalities own revenue (50.68%) and tax revenue (71.02%). 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 accounts for nearly 20% of tax revenue of municipalities in F/Y 2006/07.

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

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\(^{13}\) This was the opinion of the majority of stakeholders interviewed during the course of the assessment. Source: Draft of Annual Report on Detail Revenue and Expenditure Breakdown, 2064, LBFC
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.

The stock of unsettled accounts has accumulated over the years and appears to be growing. Long backlogs of accumulated unsettled accounts remain with less possibilities of the current leadership taking necessary initiative to settle this. 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.

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.

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.

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.

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

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

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.

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

71. 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.

72. 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.

73. The administrative head of the municipality, the executive officer, is deputed by the MoFALD, while the other staff members are hired locally. One of the biggest challenges for municipalities is updating staff capacity. 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. 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.

74. Internal audit units are not in place in most of the municipalities. 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 The practice of periodical reconciliations varies among municipalities with reconciliations done either on a monthly, quarterly, semi annual, or annual basis.

75. 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.

76. Municipalities generally rely on past trends and commitments made by donors to predict

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17 All the Executive Officers interviewed cited this aspect as a major challenge.
18 This was cited by the Executive Officers and most of the staff interviewed in the municipalities visited.
19 Except for Kathmandu, all the other municipalities visited did not have a separate internal audit unit.
20 As shared by MoFALD officials.
donor budgetary support. Donors' disbursements are timely but contingent on fulfillment of conditions and documentary and reporting arrangements.  

77. 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.

H. Procurement

79. The main challenges related to the implementation of the Public Procurement Act (PPA) 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.

80. The procurement committees established in line with the PPA 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 many municipalities.

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. 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.

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:
   (i) The ratio of bids submitted to documents distributed is very low, usually with submissions just meeting mandatory requirements.
   (ii) Collusion is rampant with successful bids very close to the budgeted provision.
   (iii) The practice of technical audits is nominal and there is low level of monitoring of

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21 As shared by officials in the municipalities visited.
22 As identified by the GoN assessment of the Public Financial Management Performance Measurement Framework (as of 2005/06) that was published in February 2008.
23 This was the case in five of the six municipalities visited.
24 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.
25 The officials of PPMO and municipalities interacted expressed this.
26 The officials of Auditor General Office, who conduct performance audit on sample of local bodys, 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.
27 As pointed out by the officials of the Attorney General Office, National Vigilance Centre and officials at the municipalities visited.
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.

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

**Box - 2: 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.

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28 As pointed out by the officials of the municipalities visited.
29 As pointed out by representatives of FCAN and CDOs.
30 This is the general opinion of all key stakeholders interviewed.
31 This was cited by the FCAN and most of the officials in the municipalities visited.
32 This was cited by contractors interviewed in Biratnagar.
33 This was cited by all the officials of FCAN who interacted with the study team.
I. Corruption

85. 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.

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

87. 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 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.\(^{34}\)

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 until very recently - the regional offices of CIAA are now being opened in regional centers. Previously, the district administration, with the Chief District Officer (CDO) at the helm, had 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 reported cases of corruption remain low\(^ {35}\) and mostly unresolved at the local level. Cases are generally forwarded to the center as the

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\(^{34}\) CIAA and opinion expressed during interaction with CIAA officials and CDOs.

\(^{35}\) As shared by CDOs in the district visited.
staff are overworked, lack investigation skills, and are subject to constant political pressure.\textsuperscript{36}

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., 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

\textsuperscript{36} As shared by CDOs in the district visited.
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. 37

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

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

IV. ADB PROJECT SYSTEMS

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

B. Financial management and implementation

104. The designated Executing Agency (EA), the MoUD 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.

105. 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.

106. Project implementation delays in ADB funded projects, in Nepal, are comparatively higher than the South Asian and the 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%. 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 frequent bandhs (closure) and strikes and the long standing environment of political instability in the country.
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 undertaken by the consulting firm, New ERA, highlighted the following problems encountered by the Project:

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

(v) 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 carry out 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.

C. Project procurement systems

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.

109. 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.

### Box - 3: 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.

D. Corruption

110. 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. “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”. 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.
111. 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. In general, ADB’s projects also encounter similar corruption risks prevalent in the overall urban development sector.

V. DONOR ENGAGEMENT

A. Current and planned donor support and financing mechanism

112. 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 20 years.

113. The World Bank: 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. 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 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.

114. United Nations Development Programme (UNDP): 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.

38 www.worldbank.org.np
39 www.undp.org.np
– 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.

115. **German Technical Cooperation (GTZ)**\(^{40}\): 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.

116. 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).

VI. **LESSONS LEARNED**

117. Over the years of ADB’s assistance to the country and the sector, valuable lessons have been learned. Major lessons learned based on various evaluation reports are as follows:

(i) 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.

(ii) 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.

(iii) Major lessons learned from ADB’s previous urban infrastructure development projects in Nepal were as follows:

(iv) 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,

(v) Physical works should be tendered in relatively large packages to attract bigger and more experienced contractors. No contractor should be allowed to bid for

\(^{40}\) [www.gtz.de/Nepal](http://www.gtz.de/Nepal)
further packages before they have substantially completed their current project,

(vi) 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),

(vii) Advance procurement action, especially for consulting services, should be seriously considered to reduce delays at project start-up,

(viii) 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,

(ix) 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,

(x) Project designs should incorporate better environmental monitoring mechanisms, including the collection of baseline data,

(xi) 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.

(xii) 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.

(xiii) 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.

VII. RISK MANAGEMENT PLAN

118. 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:

| Cluster I: Technical assistance for capacity building of municipalities |
|-------------------------------------------------|---------------------|-----------------------------|
| Major Risks                                      | ADB Actions         | Indicators                  |
| 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 |
| High dependence on government grants and Local Development Fee | Support municipalities to develop strategic business plans. | Accomplishment of targeted capacity building programs |
| Support municipalities to enhance tax base assessments | Noticeable improvement in financial management |
| Support the preparation of phase out plan of local development fee with alternative source of revenue in | 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 |
### 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.

### 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
- 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.
  - Settlement of unsettled accounts are as targeted.

### B. PROCUREMENT RISKS
#### Cluster I: Technical assistance for capacity building of municipalities
- 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.
  - There is improvement in the quality of goods, works and services procured.
- No systems for quality control and performance evaluation for procurement works
  - Train relevant officials in quality control and performance evaluation for procurement.
  - Performance audits are in place and complied.
- Absence of performance audit
  - Ensure that performance audit is a precondition for ADB projects in municipalities.

#### Cluster II: Advocacy and lobby for policy and regulatory reforms
- Bribery 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.
- Regulating line agencies, PPMMO and municipality councils do not exercise sufficient rigor to promote procurement integrity and combat corruption
  - Implementing line agencies develop and implement relevant action plans and implement codes of ethics and integrity to be ratified by EAs and municipalities.
  - Relevant action plans and codes of ethics and integrity are in place and complied.
  - Database is created and updated.
- Disbursements are influenced by political influence/interference
  - Support the formulation of communication strategy to ensure that the public is informed of all processes and financial disclosures of municipalities and its projects.
  - Strategy is formulated and applied and the level of awareness of user groups and the general public is enhanced.
  - Blacklist is created and made public.
- Set up a committee comprising CDO, Local Development Officer (LDO), 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

| Procurement is not acknowledged as a profession and specialized personnel are not inducted. | Support the creation of specialized “procurement official” job classification in big municipalities (sub metropolitan and metropolitan cities). Provide regular and expanded training to officials responsible for procurement functions and members of procurement committee. Establish and implement professional qualification and certification. | Procurement official is in place. Regular trainings are conducted and trainees are certified and accredited. |
|Procurement plans (PP) are not prepared for use in budget formulation; procurement is not guided by specific procurement manuals. Collusion is rampant and threats, intimidation, and extortions are common practices Raising of threshold from rupees 3.5 million to rupees 6.0 million for procurement of works| Provide support to develop capacity of municipalities to prepare PP and manuals and ensure that PP is part of MC & PM. 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 Support amendment of Public Procurement Regulation (PPR) so that the threshold is lowered to|
| | PP and manuals are in place within planned time frame. Compliance of MC & PM Multiple place bidding and e-bidding are in place and practiced The targeted familiarization programs are carried out Instruction manual is formulated PPR is amended and enforced. |

C. CORRUPTION RISKS

Cluster I: Technical assistance for capacity building of regulating agencies

| Low capacity of the district administration office (DAO) in the investigation of corruption cases Weak enforcement of laws and regulations at the micro and macro level | Provide resources for capacity-building of DAO in prevention and investigation of corruption 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 | The targeted numbers of capacity building programs are completed. The capacity of DAO in prevention and investigation of corruption is enhanced 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

| CIAA presence at the district | Lobby and support the | CIAA offices established at the |
| | | |
level is limited to deputation of legal officer in some District Administration Offices. No institutional presence at the local level. 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. Law enforcement agencies are perceived to be corrupt. establishment of CIAA offices at the regional level Lobby and support for permanent staff at the CIAA Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns

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<tr>
<th>II. ADB SYSTEMS</th>
<th>A. FINANCIAL MANAGEMENT RISKS</th>
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<tbody>
<tr>
<td><strong>Cluster I: Technical assistance for capacity building along with relevant lobby and advocacy support for policy and regulatory reforms</strong></td>
<td></td>
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<tr>
<td>Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users' groups.</td>
<td>Exercise more rigor on the conduction of project viability and appraisal, especially taking ground realities into consideration.</td>
</tr>
<tr>
<td>The actual revenue generation from sub-projects does not match revenue projections adversely affecting financial sustainability and loan repayments.</td>
<td>Focus on increasing interaction and involvement of TDF appraisal team with consultants given the responsibility of project design and techno-economic feasibility study.</td>
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<tr>
<td><strong>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.</strong></td>
<td>Focus on programs that raise community awareness on issues related to project sustainability.</td>
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<tr>
<td><strong>B. PROCUREMENT RISKS</strong></td>
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<tr>
<td><strong>Cluster I: Technical assistance for capacity building along with relevant lobby and advocacy support for policy and regulatory reforms</strong></td>
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<tr>
<td>Collusion, bid-rigging and cartelism in procurement of goods, works and services are prevalent.</td>
<td>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</td>
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<tr>
<td>Lack of contractor performance oversight, weak monitoring and evaluation by community users' groups and municipalities' officials lead to acceptance of substandard</td>
<td>Support municipalities to develop and apply effective monitoring systems Conduct mid term and final technical audits before</td>
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construction and/or the use of inferior materials that do not meet design specification.

acceptance of end product

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

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<tr>
<th>Executing and implementing agencies do not have an effective anti-corruption strategy or action plan</th>
<th>Support GoN for the preparation of an anti-corruption strategy and action plan for ministries/line agencies and local bodies</th>
<th>Anti-corruption strategy and action plan are in place and complied. Decrease in level of corruption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political interference, conflicts of interest and nepotism in user groups selection</td>
<td>Support MoFALD for the preparation for UG selection criteria</td>
<td>Guideline is prepared and complied</td>
</tr>
<tr>
<td></td>
<td></td>
<td>UG selection demonstrates greater transparent process</td>
</tr>
</tbody>
</table>

119. 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:

<table>
<thead>
<tr>
<th>Major Risks</th>
<th>ADB Actions for Mitigation/Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Public Financial Management</strong></td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>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 MoFALD and in consultation with all municipalities. Advocate that MC &amp; PM applied for government grants ensure the incorporation of these issues.</td>
</tr>
<tr>
<td>Low commitment to address auditor's comments and suggestions including regularization, realization and settlement of unsettled accounts.</td>
<td></td>
</tr>
<tr>
<td>Risk of cost and time overruns of sub projects owing to disbursement delays, strikes and closure and low capacity of community users groups.</td>
<td>Develop monitoring mechanism in ADB projects to ensure that disbursements are made on time be 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.</td>
</tr>
</tbody>
</table>

<p>| <strong>B. Procurement</strong> | |
| 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 Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns |
| 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 |
| 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- |</p>
<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Procurement plans (PP) are not prepared for use in budget formulation and procurement is not guided by specific procurement manuals.</td>
<td>bidding and to develop simple instruction manual</td>
</tr>
<tr>
<td></td>
<td>Provide technical assistance to develop capacity of municipalities to prepare PP and manuals and advocate to ensure that PP is part of MC &amp; PM.</td>
</tr>
<tr>
<td>C. Corruption</td>
<td></td>
</tr>
<tr>
<td>Executing and implementing agencies do not have an effective anti-corruption strategy or action plan.</td>
<td>Provide technical support GoN for the preparation of an anti-corruption strategy and action plan for ministries/line agencies and local bodies Lobby and support the establishment of CIAA offices at the regional level</td>
</tr>
<tr>
<td>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.</td>
<td>Lobby and support for permanent staff at the CIAA</td>
</tr>
<tr>
<td>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</td>
<td>Support anti corruption organizations and civil society organizations to launch anti-corruption campaigns</td>
</tr>
</tbody>
</table>