

Adapting Local Agricultural Services to Federalized Nepal: 7



A Robust System of Fiscal Governance in *palikas*

This is the seventh Briefing Note in a series drawing on the experiences of the Nepal Agriculture Services Development Programme or Prayas (January 2016 - November 2020), a bilateral initiative of the Governments of Nepal and Switzerland (Swiss Agency for Development and Cooperation, SDC) with technical support from Helvetas Nepal. The project covered 61 selected *palikas* in provinces 1, 3 - Bagmati and 6 – Karnali (the latter in collaboration with the ASDP, Agriculture Sector Development Project).

This Briefing Note outlines how Prayas supported *palikas* in developing a robust system of fiscal governance. The National Natural Resource and Fiscal Commission, NNRFC, Act (2017) mandates a Commission of the same name - which is yet to be formed - to allocate fiscal equalization grants and conditional grants to the *palikas* according to their performance in the previous fiscal year. In addition, the Local Government Operations Act, LGOA (2017) requires *palikas* to formulate and implement financial policies, systems and strategies including plans and budgets, accounting policy and procedures, financial and administrative rules and regulations, and to establish public procurement procedures and financial standards/norms according to their local context. A transparent and accountable fiscal governance system is clearly essential for *palikas* to operate effectively – not only in support the agriculture sector, but in all matters. However, this is not easy to set up, and certainly proved to be a major challenge in the early days of federalization, when most elected representatives and staff had

limited knowledge of fiscal governance. Furthermore, frequent transfers of staff have meant that *palikas* often had to deal with a gap in the human resources necessary for financial administration.

Types of federal transfers or grants

The federal constitution defines four types of federal transfers or grants to provincial and local (*palika*) governments:

- **fiscal equalization grants** – allocated from federal to provincial and local governments and from provincial to local governments, depending on their respective needs and capacity to generate revenue
- **conditional grants** – project-based grants, allocated solely for specific project purposes, from federal to provincial and local governments and from provincial to local governments
- **complementary (matching) grants** are specifically for infrastructure development, allocated from federal to provincial and local governments and from provincial to local governments
- **special grants** targeted for specific purposes and limited to basic services – allocated from federal to provincial and local governments or from provincial to local governments.

In addition, provincial and local governments each receive 15% of revenue from domestic Value Added Tax (VAT); similarly, each receives 25% royalty from the exploitation of natural resources. The remainder is retained by the federal treasury (as set out in the Intergovernmental Financial Arrangements Act, IFAA, 2017).

What did the project do?

Prayas recognized the importance of sensitizing elected representatives and staff to mechanisms of *palika* financial management - including procurement, financial systems and compliance, internal control systems, and procedures for periodic financial assessment. The fact that Prayas provided some small budgetary support for the *palika's* agriculture sector (as a conditional grant – see Briefing Note 4) provided an entry point for discussion on fiscal governance and helped gain the trust of the *palika* finance teams. Prayas piloted a fiscal governance improvement process in eleven *palikas* of province 1 – organizing workshops in which elected representatives and staff assessed their fiscal governance procedures, identified areas requiring improvement, and planned accordingly. As a result, Prayas developed a handbook for *palikas*, setting out the steps for conducting a fiscal governance self-assessment and preparing a Financial Management Improvement Plan (FMIP). In all cases, Prayas provided on-site coaching to *palika* elects and staff when they were preparing their FMIP, covering aspects such as the governance system, planning and budgeting, fund flow, revenue administration, procurement, financial management and reporting, audits, internal control and compliance, public accountability and transparency. The *palikas* were also provided support in budget preparation during their annual program development. Most of the *palikas* started budgeting using the online Sub-National Treasury Regulatory Application (SuTRA) in the financial year 2018/2019; this became mandatory from 2019/2020 onwards.

Although Prayas intervened to support the *palikas* in developing their agriculture sector, in respect of fiscal governance, the support provided covered all aspects of *palika's* work.

Key achievements

- Despite internet problems and staff transfers, most project *palikas* are gradually adopting SuTRA - thereby improving record keeping and the reporting of financial transactions.
- All the *palikas* have developed their financial management capacity and systems, and have thereby improved financial reporting, developed procurement guidelines for contracting services, and reduced fiduciary risks.
- Some *palikas* have developed their own rules and regulations for fiscal governance including local level

public procurement regulations, genuinely participatory public hearings/audits and settlement processes for audit irregularities.

- Through implementing their FMIP, eleven *palikas* have strengthened their financial management and governance. The exercise has also been a good preparation for statutory assessment by the National Natural Resources and Fiscal Commission which will be conducted soon and will determine their performance-based grant allocation.
- Eight of the *palikas* have not only started implementing their FMIP but are now working on a Revenue Improvement Action Plan, under which they are investigating means to raise their own income. They have begun campaigns for tax collection and have gained confidence in exploring external sources of funding.

Challenges

In the early days of federalism, the rudimentary understanding of fiscal governance amongst most *palika* elected representatives and staff was a major handicap. Furthermore, they were dealing with federal administrators who retained a federal mindset; thus, for example, *palika* officials were asked to commute to former district headquarters during financial audits instead of the officials coming to them. The reporting template of the Office of the Auditor General (OAG) was also not adapted to the federalized system and did not recognize different sources of funding – assuming that all had been dispersed from the federal treasury and thus had to be returned if unspent. Frequent staff transfers were another significant challenge. Gradually these issues are being resolved, although the regular turnover of staff remains problematic.

Lessons learned

- The building of an **effective system of financial management** is crucial; although strictly speaking, Prayas was only concerned with the fiscal governance of agriculture sector support, addressing this on its own made no sense. Facilitating a functioning system of fiscal governance for the *palika* overall, rather than focusing on one small part, was an important lesson that is also relevant for other development partners.
- **Hands-on learning** through on-site coaching to all concerned – elected representatives, administrative and other staff – is an effective model of support, boosting confidence, ownership and accountability.
- The **orientation of federal staff** within the Office of the Auditor General (OAG) was also important, as they found it difficult to adjust to the new federal set-up.

“Previously Prayas organized interaction/orientation programs only on technical matters, but this time it also organized a workshop on public financial management which has really been useful and relevant to us in the current context.”

Kumari Thakuri, Vice-chairperson, Rautamai *gaunpalika*

“The content of this orientation on Public Finance Management are aptly chosen and designed. The facilitators are also expert of their sector. This is the first time we have attended such a workshop in which we are discussing critical issues related to public finance management among the elects and staff”.

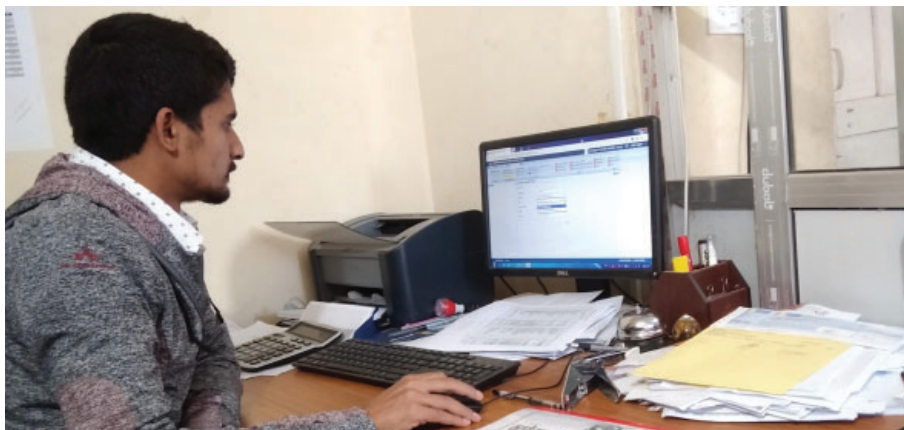
Shiva P. Humagai, Chief Administrative Officer (CAO), Chaudandigadhi *nagarpalika*

“This workshop on public finance management has been one of the best workshops that I have ever attended”.

Bed Bahadur Rokka, Chairperson of Khijidemba *gaunpalika*

“Initially Aishelukharka *gaunpalika* operated by adhering the Government of Nepal’s Public Procurement Act and Procedures.... After attending the Prayas-organised Financial Management Workshop for elected representatives and staff, we came to know that a draft Local Level Public Procurement Procedure was available on the website of the Ministry of Federal Affairs and General Administration. Post training, this draft was discussed in our Legislature Committee and was then approved on 5th December 2019 and published in the Local Gazette on 8th December 2019. Following the approval of our own local procedure, public procurement has been much easier, particularly for *palika* staff members. The CAO [Chief Administrative Officer] is now allowed to approve the procurement of up to NPR 5 crore and since there is clear provision for the *palika* chairperson being ranked one step above the CAO, there is a better coordination and closeness between the elected representatives and staff members; the Act has helped to bridge the former gap between us.”

Buku Prasad Acharya, Chief Administrative Officer, Aishelukharka *gaunpalika*



Photos:

(first page) Happy harvest! Kamala Gautam in her apple orchard located in Gautamwada village of Tatopani *gaunpalika*, Jumla. The *gaunpalika* has prioritized apple as topmost value chain and has been promoting organic pocket production utilizing its agroecological niches.

(last page) above: Padma Kumari and Bhanubhakta Ghimire with their son using a multi-crop thresher to thresh rice. The Kathahare farmers group received the thresher from Rawabesi *gaunpalika* in collaboration with Prayas; the group lends the thresher to its members during harvest season based on pre-agreed guidelines.

(last page) below: Dornidhi Subedi, assistant accountant in Katari nagarpalika, entering the annual plan and budget endorsed by municipal assembly in Sub-national Treasury Regulatory Application (SuTRA).