

NEPAL PORTFOLIO PERFORMANCE REVIEW (NPPR) 2006

Memorandum of Understanding (MOU)

Background

1. The Government of Nepal (GON) and three of its development partners, Asian Development Bank (ADB), Japan Bank for International Cooperation (JBIC), and the World Bank (WB) have been undertaking joint portfolio review exercise over the past six years. As agreed during the last NPPR, the Government of Nepal organized and led the portfolio review process for the first time this year. This carries a special importance, for it also reflects the shift in the focus of the portfolio review from the performance of a narrow set of projects to improving budget outcomes more generally. It aims end an artificial bifurcation between donor funded projects and GON funded projects. The Vice-Chairman of the National Planning Commission, the Chief Secretary and the Finance Secretary stressed the need for integrating portfolio review exercise with the budget performance towards outputs and important policy announcements. There is a strong commitment from GON to address generic implementation issues that affect implementation and budget outturns targeting to a level of 95 percent during FY2006/07. Hence, the portfolio review exercise this year has begun to take a major shift to look at a larger development picture than focusing narrowly on projects financed by ADB, JBIC or World Bank. Improvement in overall portfolio performance is critical for effective budget implementation and to achieve Nepal's development agenda. This shift in approach is a test and challenge for GON to integrate the portfolio review exercise with the review of overall budget performance focusing on outputs as well as outcomes, and important policy announcements.

Rationale and Aims

2. As part of the annual review process, GON in close collaboration with ADB, JBIC and WB conducted a Nepal Portfolio Performance Review (NPPR) led by the Ministry of Finance (MOF) on September 4-5, 2006 at the MOF premise. The evolving partnership among the three key development partners ("Partners") – ADB, JBIC and the World Bank – is promoting a new way of portfolio management and support. The Partners will continue to work with GON to make the NPPR a dynamic process, which is forward looking and linked to review of budget implementation performance towards outputs and results. From this review, GON has begun the process of integrating portfolio management and review process in its aid integration process and Medium-Term Expenditure Framework (MTEF). During this year's review, GON invited major bilateral donors as observers, which are supporting GON in two sector-wide programs in the education and health sectors, and they include DFID, DANIDA, Finland and Norway.

3. The popular movement of April 2006 has brought a very unique moment for the Government of Nepal, an open moment to chalk out a new path towards an inclusive, prosperous and peaceful Nepal. Democratic institutions have been reinstated, and avenues for a lasting peace have now opened up. New prospects for socio-economic transformation have emerged. As claimed in the Budget FY2006/07, democracy cannot flourish on the foundation of a weak economy. The economic activities suspended during the period of conflict, insecurity and absence of people's representative, are now rekindled towards productive development efforts. Thus, there is a space, as well as, dire need for a renewed compact between the state as provider of development services and development demands. And, this is a critical time to begin this new partnership. Against this background, the current NPPR came up with a new theme "**Budget Implementation and Improving Portfolio Performance**". The Budget FY2006/07, among several other interventions undertaken by the Government of Nepal, directly aims to raise and meet the expectations of the enormous popular energy that brought about political changes in April 2006.

4. GON proposes a renewed effort to address generic implementation issues which include improving public procurement, financial management and project management; most of these are to be

addressed through the MTEF process, improving public expenditure management, prioritization of expenditures at the level of programs with clear links to outputs and outcomes. GON will continue to take the full ownership of portfolio review with a view to scaling up to a broader review process focusing on results. The portfolio review process will gradually become an integral part of the Government's regular planning, programming, budgeting and donor consultation process. GON proposes portfolio review to focus on the review of the implementation of immediate fiscal year budget performance towards outputs and results, and important policy announcements – this will be held annually in September. The mid-term review of budget implementation will be around February/March each year – the review will extend to the review of implementation progress in a few sample projects, comprising good and bad portfolio. MOF will select a sample of projects for this purpose on the basis of certain criteria to be specified in the Road Map.

5. This participatory approach, in line with the Paris Declaration on Aid Effectiveness, aims to:
- (a) foster country ownership and accountability of government to the citizens;
 - (b) ensure that the NPPR becomes a GON driven process with its full commitment and ownership of its development projects and programs;
 - (c) enhance aid effectiveness through alignment of aid to country's priorities and its results focused and predictable;
 - (d) manage for development results by placing sharper focus on outcomes, strengthened project and/or sector management and administration which includes capacity building in procurement and financial management, and emphasis on operations and maintenance to ensure sustainability;
 - (e) encourage the development partners to harmonize procedures and requirements (relating to reporting, fiduciary requirements, monitoring and evaluation, environmental and social safeguards, etc.) to reduce burden on implementing agencies; and
 - (f) ensure better exchange of information and knowledge among the partner agencies.

New Approach to Portfolio Review

6. GON aims to move a step forward with a new approach of portfolio review – in this respect, GON proposes to include major bilateral donors in the exercise from FY2006/07 review. The review will align with the Government's own Fiscal Year, and will be coordinated by the Ministry of Finance (MOF) every year within six months of the end of the Fiscal Year. The main outcome of such a review will be a set of recommendations for reforms, which will be input to the Government's Immediate Action Plan (IAP) for the subsequent year. This approach is expected to lead to implementation of reform actions that will directly contribute to overall development performance and effectiveness. Through the linkage of portfolio review with the budget exercise, GON also plans to require rigorously all development projects to submit procurement plan at the time of budget finalization. This is expected to reduce severe procurement delays which have been the root cause of poor project performance. GON will continue to adopt the Project Readiness Filters agreed during NPPR 2005, which is attached with this MOU (**Attachment - 1**), to ensure that (i) only those projects that are screened through the Filters would be accepted for implementation, and (ii) project/program conditionalities would be addressed before the negotiations or the Board consideration.

Action Plan

7. This year's review focused on some key implementation issues that have direct bearing on the outcome of low budget outturns. First, at the planning and budgeting stage, budget allocation approval is not done in conjunction with approval of annual activity and procurement plans. This delay in approval of these two plans, some done only in second trimester, naturally cascades down to the implementation phase. This must improve. Second, line ministries must prepare work program and budget for the succeeding year proactively so that all envisaged programs are defined in the budget and discussed with NPC and MOF. Lessons learnt from the past must be applied while formulating next year's budget. Third, at the implementation stage, weak monitoring and evaluation systems or ineffective use of the systems in place have not only weakened timely assessment of implementation but also project outputs and impacts. Actions agreed with development partners or ministerial level reviews' recommendations are not closely monitored within the system, hence resulting in slippage of implementation. Fourth, timely reporting of the implementation of budget is of paramount importance to monitoring the progress and identifying the challenges. Fifth, maintaining the records and accounts of budget heads and ensuring timely preparation of accounts to enable for timely audit is another area of focus that relates to better accountability and governance. Underpinning these issues, the discussion themes selected for this year's portfolio review were (1) **How do we Improve Results Based Reporting?** (2) **How do we Improve Financial Reporting?** and (3) **How do we Improve Procurement Management?**

Commitment from the Government of Nepal

8. Three working groups worked on these themes and submitted the recommendations to the Government addressing these themes. **Attachments 2, 3 and 4** respectively present the summaries of discussions of each working group. **Attachment 5** presents the Agenda of NPPR 2006. GON has made a commitment to review the recommendation of the working groups, synthesize and prioritize them, and prepare plan to implement actions that help implementation, by November 30, 2006. As part of the Public Financial Management Sector Work, GON also commits to establish benchmarks for high level set of Public Expenditure and Financial Accountability (PEFA) Indicators by June 30, 2007, and move towards capacity building of public financial management with the cooperation of development partners. Similarly, GON also commits to continuing with public procurement reform establishing a separate Public Procurement Oversight Office (PPMO) proposed in the draft Act to be established in the Prime Minister's Office following the enactment of Procurement Law. In the context of Public Financial Management (PFM) Sector Work, GON also commits to establishing procurement monitoring indicators by June 30, 2007 as per the OECD/DAC Guidelines. GON will implement these actions in close collaboration and cooperation from development partners.

Commitment of the Development Partners

9. The Partners (ADB, JBIC and World Bank) agree to undertake the following specific actions, in addition to their fiduciary responsibilities of undertaking oversight functions in procurement reviews and financial management reviews:

- (a) Annually review and discuss project/program supervision strategies, with full involvement of GON counterparts in order to increase the effectiveness of supervision teams' inputs;
- (b) Consult in advance (at least two weeks ahead) with GON Project Team when planning supervision missions, especially the scope and timing of such missions and sharing project performance reports;
- (c) Respond in a timely manner (within three weeks from the date of package received) to procurement related decisions;

- (d) Process in a timely manner (within three weeks from the date of request received) the payments including reimbursement;
- (e) Respect and comply with GON's Foreign Aid Policy 2002 and the Poverty Reduction Strategy Paper (PRSP) at the time of preparation of new projects/programs;
- (f) Support training programs in key areas of project management, including procurement, contract administration, financial management, monitoring & evaluation, and operations and maintenance;
- (g) Proactively share and implement "good practices" in working with communities, local bodies and government local agencies, in critical project areas: monitoring and evaluation, procurement, work programs and financial management; and

10. Attachment 6 summarizes the Key Action Plan agreed during this NPPR.

Transparency

11. GON and Development Partners agreed that the signed MOU will be posted in the website of MOF and the respective sites of the development partners to make the process transparent.

Signed in Kathmandu
September 11, 2006

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