Fifty-first (51st) Annual Report of the Auditor General 2070 (2014)

Summary

Office of the Auditor General

Babar Mahal, Kathmandu

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Babar Mahal, Kathmandu

Vision

An independent, efficient and effective audit institution to promote good governance.

Mission

Provide quality audit service to the nation for the efficient management of public resources.

Values

- Independence,
- Integrity,
- Credibility,
- Professionalism, and
- Serving the public interest.

Auditor General
Nepal

Babar Mahal, Kathmandu
Nepal

Summary of Report

Today I submitted the fifty first annual report to the Right Honourable President in accordance with the Interim Constitution of Nepal, 2063 (2007). The report has been made public through the website of this office www.oagnep.gov.np.

This summary book has been prepared based on the main report with the objective of enhancing accountability and transparency by providing information to the general public about the result of audit of the public financial management of the country.

(Bhanu Prasad Acharya)
Auditor General

28 Chaitra 2070
(11 April 2014)

PREFACE

As the Interim Constitution of Nepal, 2063 (2007) had accepted providing good governance is the responsibility of state, state machineries should be mobilized to meet public aspirations and to establish the foundations of good governance right from the level of service delivery to policy making level. Government has established legal, structural, administrative procedures to transform society by making administration citizen friendly and responsive to public expectation though constitutional state. The foundations of transparency and accountability should also be established in order to ensure that the governing procedures and public service delivery system are in line with public expectation. In this context, different government mechanisms and constitutional bodies are established and in operation to provide oversight on administrative and financial activities of government.

There is a close inter=relationships between public financial management reform and the outcomes of development. Economic and political stability are the contributing factors to achieving development outcomes. The main foundations of enhancing effectiveness of state system are competencies in the distribution and utilization of resources, effectiveness in delivery of services and providing the assurance of good governance. Ultimately, strengthening of democracy is ensured through built in competence of these foundations. In our capacity as the Supreme Audit Institution (SAI), we are committed to contribute in enhancing accountability and transparency in public financial management system in the present context of public expectation to end unstable environment with the recent election of the Constituent Assembly.

With the objective of improving public financial management system, the Government has implemented important programs that includ Medium-Term Budget Framework (MTBF), Nepal Public Sector Accounting Standards (NPSAS), Public Procurement Act and Regulations, Treasury Single Accounts (TSA) System, management reform of public administration and revenue administration. These programs have contributed in maintaining discipline in public administration in broad term and in financial administration and disseminating financial information. However, management of state machineries and the roles played by public office holders are not yet meeting the expectation as per the aspiration of the Constitution. An attempt has also been made to evaluate the roles played by the responsible officials from the perspective of transparency and public accountability in the public financial management.

Formulation of planning and budgeting and their implementation, maintaining accounting system and audit are recognized as the important aspects of public financial management. The results of audit of the planning and implementation of budget are accepted as the basis of measuring of fairness and the quality of public financial management. There are risks of various nature including noncompliance with existing law, not achieving progress as planned, accounts not maintained as required by related standards, not achieving outcomes in proportion to the resources used and leakage in the use of resources the acquisition and use of public resources. The Office of Auditor General (OAG) has been playing constructive and critical role in evaluating risks associated with the financial management through audit conducted in accordance with the Interim Constitution of Nepal, 2063, Audit Act, 2048 and other existing relevant laws.

The role of head of a public office also includes contributing to maintaining and promoting financial discipline by ensuring accountability and transparency through independent, impartial and objective evaluation of regularity, economy, efficiency, effectiveness in managing financial operations. OAG has been providing information and reasonable assurance to all stakeholders including government, legislature-parliament and development partners by undertaking comprehensive evaluation of the operation of public financial management, implementation of public policy and program, respect to existing law, responsibilities met by public officials.

It is indispensable to make timely reform in public auditing system to make the role of audit effective. In this context, OAG has adopted prevailing best practices in international field in order to enhance quality of audit. Since last few years, the Auditor General had reduced the time of reporting and has been submitting annual report within nine (9) months from the end of the fiscal year. This year an Audit Advisory Committee comprising experts in planning, administration, audit, legal and management has been formed to seek advice on audit strategy and reform while reporting. Programs to build organizational capacity of OAG are implemented in cooperation with supreme audit institutions of other countries and with the cooperation of development partners.

In line with the policy of reforming the quality of audit performed by the OAG, existing auditing standards and guidelines are being updated taking into consideration international standards and the risk based auditing. A system of concurrent auditing and quality assurance system are also being implemented. A system of partnering with beneficiary groups and stakeholders has been initiated in course of conducting Performance Audits. OAG needs support and cooperation from all concerned stakeholders in order to successfully implement these reform initiatives. Similarly, the Report has highlighted some recommendations have in the context of adapting some best practices that would support to enhance accountability and transparency in public finance management. As per the established practice of OAG, I have attempted to include in the Report the recommendations that would contribute to sustainable financial management system based on studies and objective facts.

Annual reports of the Auditor General have been highlighting cases that are against law and pointing out financial irregularities and anomalies. This Report has revealed the fact that transparency in public financial management has been compromised as evidenced by various factors such as, mobilization of foreign aid outside the purview of government budget administration, transparency not ensured in the statement related to technical assistance and disclosing where such assistance was received or not, increasing trend of not making available accounts of the foreign assistance by public entities for auditing, different funds operating in addition to the budgets, and public resources mobilized through different bodies and institutions. Similarly, the implementation aspect of the budget and program announced by government has been weak, projects that are recognized as national have also been not implemented as planned, budget appropriated with specific headings/sub-headings also transferred in higher/lower scale and increased the financial burden of government treasury due to delays in timely receiving reimbursement from donors in case of foreign aid. Similarly, cases of noncompliance with existing laws by public officials, the requirements set for competitive procurement not respected, revenue rebate allowed more than specified by law, tax net not expanded and audit irregularities were not cleared as required by law were widely noted.

It is obvious that implementation of audit recommendations as highlighted in previous years reports is weak as reflected by similar findings in subsequent reports. In addition to this, lack of initiative on part of the government in implementing the decisions of the Public Accounts Committee reflects weakness in financial accountability. It is expected that all concerned offices, regulatory authorities, development partners and stakeholders shall pay attention and make efforts to contribute to public financial management reform.

Finally, I wish to express my sincere gratitude to the Legislature-Parliament, Public Accounts Committee, Government of Nepal and all its organizations, development partners, civil society, media persons, general public and all those who directly or indirectly supported and contributed to the preparation and submission this report. Also I wish to specially thank all dedicated and hardworking staff and members of the OAG and professional certified auditors for having completed audit in time and supporting me to bring annual report in this shape.

(Bhanu Prasad Acharya)
Auditor General

Table of Content

Acronyms

CF	-	Consolidated Fund
FCGO	-	Financial Comptroller General's Office
FPA	-	Financial Procedure Act
FPR	-	Financial Procedure Regulation
FY	-	Fiscal Year
INTOSAI	-	International Organization of Supreme Audit Institutions
OAG	-	Office of the Auditor General
PAC	-	Public Accounts Committee
PPA	-	Public Procurement Act
PPR	-	Public Procurement Regulation
SAI	-	Supreme Audit Institution

Note:

1. In this report, fiscal year of the Government of Nepal and public sector implies the period from 16 July to 15 July. This report covers financial transactions of the fiscal year 2069/70 (2012/13).

Summary of the Auditor General's Annual Report, 2070 (2014)

1. Background

1. **Legal provision** - Pursuant to Article 123 of the Interim Constitution of Nepal 2007, the Auditor General is mandated to conduct the audit of all government offices and other organizations as specified by law following established standards and procedures considering regularity, economy, efficiency, effectiveness and propriety and submit report to the President in accordance with Article 124 of the Interim Constitution. Audit Act 1991, provides detail regarding the methodology, scope and the matters to be audited and the audit of fully and majority owned corporate bodies by the Government of Nepal. Audit has been conducted in accordance with the Constitution and the Audit Act.

2. **Objectives -** The objective of audit is to provide reasonable assurance on the following matters, with due consideration to regularity, economy, efficiency and effectiveness in the acquisition and utilization of public resources:
   - Financial statement has been prepared in the prescribed formats and transactions reported in true and fair manner,
   - Expenditure has been incurred only for specified task and purpose within the limit set by Appropriation Act,
   - All incomes including revenue are properly collected and deposited,
   - Adequate arrangements have been made for maintaining records of government property, its usage and safeguarding,
   - Effectiveness of internal control and internal auditing,
   - Financial transactions comply with rules and regulation and sufficient evidences have been maintained, and
   - Achievement of target within the stipulated time.

3. **Scope -** Audit was carried out during this year to financial transactions of fiscal year 2069/70 (2012/13) and outstanding accounts of previous years of Constitutional bodies, Ministries, Departments and Offices, Corporate Bodies, Committees, Boards, Funds, Authorities and Universities and other institutions as prescribed by law; Regularity and performance based on information technology audit has been conducted as per the approved plan.

4. **Methodology -** Audit has been carried in compliance with Audit Act, 1991, Government Auditing Standard, founding principles promulgated by the International Organization of Supreme Audit Institution (INTOSAI), audit guidelines and best practices of audit, which requires assessment of audit risks, application of test of control, analytical procedures and test of detailed to collect of relevant evidence as deemed necessary. The process of audit has been depicted in the chart.

5. **Audit Standards and Guidelines -** The following standards and guidelines were used in the process of auditing.

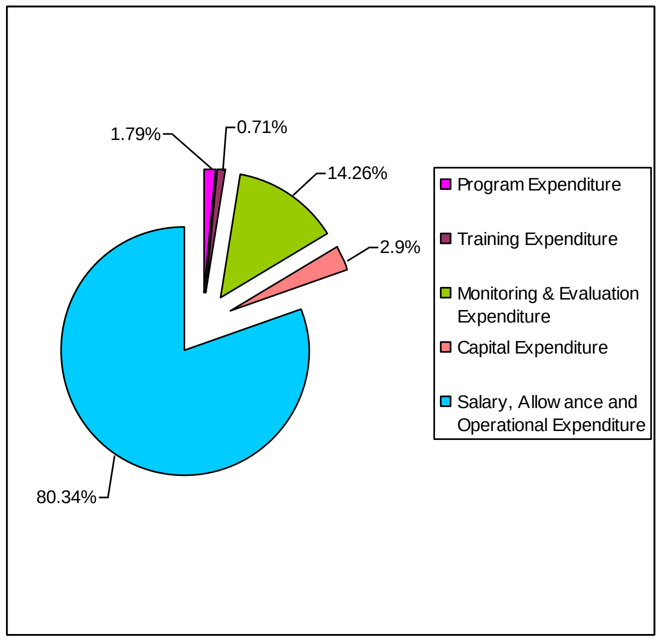
• Government Audit Policy Standards • Government Audit Operational Guidelines • Performance Auditing Guide • Guidelines for the Auditing of Corporate Bodies • Auditor General's Directives and circulars related to audit • Directives related to the Composite Audit • Quality Assurance Handbook	• Project Accounts Audit Guidelines • Public Procurement System Audit Guidelines • Administrative Expenditure Audit Guidelines • Revenue Audit Guidelines • District Development Committee Audit Guidelines • Risk based Audit Guidelines • Auditor’s code of conduct.

6. **Quality Control and Review -** The Office of the Auditor General (OAG) has adopted the quality management framework developed for Supreme Audit Institution. This structure includes arrangements related to promoting independence of auditor, provision of skilled and competent staff and their continuous development of professional skills and knowledge, preparation of auditing standards and guidelines in line with international auditing standards, their implementation and reporting accordingly by preparing strategic and annual operational plan. Supervision by senior level officials, adherence to code of conduct and enforcement of activities related internal control are in practice. A system of

disseminating the audit results has been established to maintain working relationships with the stakeholders by optimizing the use of available resources to improve public financial management.

Peer review is conducted from other SAI in order to assess the status of the implementation of quality control framework. Similarly, post quality review of 50 files is made every year upon the completion of audit. Such files are selected representing all directorates, audit teams and the nature of audit. In addition to these arrangements, one audit file of each audit team is reviewed in order to implement the performance based incentive scheme. Arrangements have been made to constitute review teams avoiding any chance of conflict of interest in the process of quality review.

7. **Organizational Management and Budget -** There are four Divisions, 14 Departments and sector-wise 27 Directorates under OAG organization structure. There is an inherent practice of carrying out hundred percent in-site audit by deputing staff throughout the country for a short period of time. There are 448 approved positions in the OAG which has not been reviewed for the last 20 years. Of the total approved budget allocation of Rs.239.80 million in fiscal year 2069/70 (2012/13), total expenditures incurred was Rs.206.71 million. Different categories of expenditures are shown in the graph. Based on the analysis of the categories of budget appropriation expenditure, the percent of expenditure incurred for training and capital cost was 0.71% and 2.90% respectively. Analysis of the total audited amount in the fiscal year 2069/70 (2012/13) amounting to Rs.2,085.80 billion revealed that the cost of per Rs. 100,000 stands at Rs. 11.20.



8. **Audit Advisory Committee –** With an objective to improve the quality of audit and taking into consideration good international practice, and in order to provide advice to the Auditor General in the field of audit process, relevant subject matter and on reporting, this year a 15 member Audit Advisory Committee has been formed which represent members specializing in various discipline. This committee has been providing advice to the Auditor General.

9. **Civil Society Participation -** The office has implemented the concept of encouraging the participation of civil society and citizen engagement in the audit process as and when

required. The office has initiated the participation of civil society and citizens in identifying risk during planning phase and source of information during implementation phase of the performance audit. In addition, the office is planning to involve civil society in disseminating results of audit at local level. The office is conscious of the fact of the need for ensuring independence of the Auditor General while involving civil society and citizens in audit process.

10. **Effectiveness of Audit -** Government treasury annually receives revenue from the cases of under collection of revenue, over payment and non-compliance with existing law which were highlighted in by audit. The comparative statement of amount recovered in the last three year is shown in the table below. Implementation of matters highlighted in connection to the compliance with rules and regulation is expected to support in maintaining fiscal discipline.

(Rs. in million)

Fiscal Year	Irregularities to be revoverable	Amount realized	Office Expenditure
48th Report (2009/10)	29,52	2,91	1,46
49th Report (2010/11)	27,69	7,12	2,04
50th Report (2011/12)	38,99	9,69	2,06

Rs. 2 billion 504 million was realized on the basis of observations highlighted by audit during the period covered by this 51st report.

11. **Stakeholder Survey -** This office collected feedback from 200 stakeholders from five districts to evaluate the effectiveness of audit which covered issues related to the quality of audit, its reliability (trustworthiness), auditor's expertise, impartiality and honesty. Out of these, 59 % opined that the role of the auditor was creative and relevant, 81% were in the veiw that audit has been supportive to increase effectiveness of management, 47% felt that auditors have necessary expertise, 59% expressed the view that audit played satisfactory role to maintain financial discipline and 58% opined that auditor’s impartiality and honesty was good.

Likewise, 58% expressed the opinion that auditors should focus their attention on the evaluation of economy, efficiency and effectiveness. OAG has adopted a policy to make timely reforms in audit considering the views expressed by the stakeholders.

2. Audit, Irregularities and Clearances

1. **Audit** - This year the OAG has conducted audits as follows:

1.1 **Government Offices** - This year a total of Rs.804.86 billion was audited covering 3,744 government offices that include accounts of appropriation, revenue and deposit as follows:

(Rs. in million)

S. No.	Transaction	Audit Conducted		
		Outstanding Amount	Amount for FY 2069/70 (2012/13)	Total
1.	Appropriation disbursed	6,94	35,93,55	36,00,49
2.	Government revenue		29,67,31	29,67,31
3.	Deposit	-	1,91,57	1,91,57
4.	Others		12,89,20	12,89,20
	Total	6,94	80,41,63	80,48,57

1.2 **Corporate Bodies -** This year the audit of 92 corporate bodies amounting to Rs.1,136.88 billion was conducted.

1.3 **Boards and other institutions -** This year the audit of 805 boards and other institutions of Rs. 69.27 billion was conducted.

1.4 **District Development Committees** - This year the audit of 75 District Development Committees amounting to Rs. 75.79 billion was conducted.

1.5 **Performance Audit** - This year 22 performance audits assignment were completed.

1.6 **Concurrent Audit** - This year concurrent audit to review the internal control system of 56 offices was conducted.

1.7 **Information Technology Based Audit** - This year information technology audit of two softwares were carried out.

1.8 **Audit Report with Opinion** – OAG has furnished audit opinion on the accounts of consolidated fund (CF).

Audit reports with opinion were issued on the consolidated financial statement of controlling entities. Audit reports with unqualified opinion were issued to compiled financial statements of three entities whereas audit reports with qualified opinion were issued to 37 entities. In case of corporate bodies, out of the 46 audit report issued, three audit reports were issued with unqualified opinion for four fiscal years including this year. Audit reports were issued to 28 corporate bodies with qualified opinion for 43 fiscal years including this and previous fiscal years.

2. **Irregularities** - Article 2 (da) Financial Procedures Act, 2064 (2007) defines "irregularity" as "financial transactions that were occured without complying the provisions stated in existing law, accounts not maintained as required by law and also the transactions made in an irregular and irrational manner".

2.1 The updated amount to be settled by the audited entities is Rs. 243 billion 98 million. This amount has been increased by 19% as compared to last year.

(Rs. in million)

S. No.	Particulars	Amount
1.	Government offices - irregularities	7,36,88
2.	Irregularities related to District development Committee, other entities and Boards	4,17,43
3.	Audit baklog	25,15
4.	Revenue arrears	9,33,63
5.	Amount to be reimbursed from donors (grant)	2,07,76
6.	Amount to be reimbursed related to foreign loan	89,59
7.	Overdue principal and interest of loan made available on guarantee	20,54
	Total	**24,31,98**

Note: 1. As the records of the irregularities prior to FY 2059/60 (2002/03) was handed over (transferred) to the Kumari Chowk and Kendriya Tahasil Karyalaya (Central Recovery Office) as per the Cabinet decision of 2069/6/11 (September 27, 2012), the irregularities amount of that period has not been included in the above table.

2. As this office does not maintain records of irregularities of corporate bodies, the above table does not include such figures.

2.2 A comparative statement of audited amount and irregularities of the government offices of the last three years is as follows:

(Rs. in million)

Report	Audited Amount	Amount of Irregularities	Percent
Fourty-ninth	52,75,61	2,25,04	4.26
Fiftieth	74,25,94	2,79,69	3.77
Fifty-first	80,48,57	2,87,59	3.57

Although total amount of irregularities has increased during this year, the percentage of irregularities has been decreased by 0.20 percent.

3. **Classification of Irregularities** - Irregularities are categorized as amount to be recoverable, non-compliance with relevant law, non-submission of evidence of financial transaction, reimbursements not received, and advances not settled (staff advances,

mobilization advances, Letter of credit advances and institutional advances). The category-wise irregularities noted from the audits of government offices, committees and other institutions and corporate bodies is given as follows.

(Rs. in million)

Classification	Government offices	Committees and other corporate institutions and DDC	Total	Percent of total irregularity
Total irregularities	**2,87,59**	**78,42**	**3,66,01**	**100.00**
1. To be recoverable	28,78	8,71	37,49	10.24
2. To be regularized	1,27,05	61,00	1,88,06	51.38
• Non-compliance	38,56	20,62	59,18	16.17
• Non-submission of documentary evidence	79,21	39,48	1,18,69	32.43
• Balance not carried forward	39	5	44	0.12
• Reibursement not obtained	8,90	85	9,75	2.66
3. Advances	1,31,76	8,70	1,40,46	38.38
• Staff Advances	1,60	48	2,08	0.57
• Mobilization Advances	45,17	-	45,17	12.34
• LC Advances	31,29	-	31,29	8.55
• Corporate/Institutional Advances	53,70	8,22	61,92	16.92

Irregularities related to government offices as compared to total audited amount stands 3.57 percent. Out of the total irregularities, revocerable amount is 10.24 percent. Similarly, the irregularities regarding advances is 38.38 percent, which is lowered by 3.53 percent compared to last year.

Government entities with no substantial irregularities are the Office of the President, Office of the Vice-President, Constituent Assembly, Legislature - Parliament, Commission on Investigation on Abuse of Authority (CIAA), Office of the Auditor General (OAG), Judiciary Council, National Human Rights Commission, Ministry of Law, Justice Constitution Assembly Legislature and Parliament and Ministry of Youth and Sport.

4. **Settlement of irregularities** – Status of this year regarding settlement and follow-up of irregularities is given as follows:

(Rs. million)

Particulars	Irregularities of the previous years	Added by Adjustment	Settlement through follow-up audit	Irregularities of Current Year	Status of outstanding irregularities
Government offices	6,62,63	(66)	2,12,68	2,87,59	7,36,88
Corporate bodies, Committees and other institutions	3,74,51	73	36,24	78,42	4,17,43
Total	**10,37,14**	**7**	**2,48,92**	**3,66,01**	**11,54,31**

Deliberations on the 49th and 50th Annual Reports of the Auditor General have not yet been discussed in the Public Accounts Committee. Discussions of a few entities of previous reports are also pending .

Out of the irregularities of Rs. 24 billion 892 million this year, the Ministries of Urban Development, Irrigation, and Physical Infrastructure and Transport settled Rs. 6 billion 48 million. Out of the total advances outstanding, mobilization advance constitutes Rs. 4 billion 373 million (72.25 percent). Such advance would be settled automatically when payments of running bill of construction work is made. There is a situation of receiving incentives when irregularities are settled through normal process and audit entities are not paying adequate attention to clear other irregularities.

3. Highlights of Some Audit Observations

1. **Status of Public Accountability:** With regard to public accountability, Auditor General's prospective has been presented as follows:

Auditor General's Prospective on Public Accountability

Revenue Leakage

- Failure to bring potential tax payer in the tax net,
- Collection of revenue not made as per law,
- Revenue exemption given in illegitimate manner,
- Increasing trends of revenue arrears,
- Less tax collection due to unfair presentation of financial transaction,
- Low number of tax audit,
- Increasing trends in revenue exemptions.

Contract Management

- Contract not awarded in time,
- Procurement not made in a transparent manner through competitive process,
- Non completion of contract in time,
- Actions not taken against the contractors who fail to complete works within stipulated time,
- Works executed against rule through User's committees.

Status of Public Corporations

- Most of the corporate bodies facing financial loss,
- Assets in negative threats going concern,
- Loan taken by non operating corporations for administrative expenditures.

Project Management

- Noncompliance with the basis of projects selection,
- Priority projects not implemented in a planned manner,
- Non availability of sufficient budget,
- Foreign aid not mobilized in line with objectives,
- Non achievement of target.

Budget Discipline

- All foreign aid, including technical or commodity aid not included in budget,
- Expenditure incurred from contingency budget without allocating to specific head,
- Authorization not issued in time,
- Non compliance of law in virement,
- Expenditure incurred exceeding budget.

Internal Control

- Lack of effective internal control system,
- Monitoring and supervision not undertaken by responsible person,
- Internal auditing system not reliable,
- Accounts not maintained as per the accounting standards,
- Non presenting fair income and expenditure of the government by the consolidated financial statement because all transactions are not incorporated in accounts,
- All transactions are not covered by Treasury Single Account.

Ownership of Responsibility

- Financial transaction are not submitted for audit within the period specified by law,
- Responsible official not initiated action in a timely manner to settle irregularities,
- A number of foreign aid are not in the purview of public auditing,
- Lack of implementation and monitoring of the Decisions of Public Accounts Committee,
- Total accumulated irregularities amount to be recovered and reconciled is Rs. 243 billion 98 million.

- **Economic Indicators, Income and Expenditure**

2. Overall Economic Situation - Despite policy efforts made by the Ministry of Finance (MOF) in maintaining the overall economic stability, the status of some of the important economic indicators during the three year plan period (2010/11 - 2012/13) are as follows:

(In percentage)

Indicators	Target for the plan period	Achievement		
		2067/68 (2010/11)	2068/69 (2011/12)	2069/70 (2012/13)
Economic growth rate	5.5	3.9	4.5	3.5
Employment growth rate	3.6	2.9	2.9	2.9
Inflation rate	7	9.6	8.3	9.9
Population under poverty line	21	25.2	24.4	23.8
Total Revenue/Domestic Production	17.3	14.6	16.1	17.4
Total Expenditure /Domestic Production	25.8	21.6	22.1	20.9
Current Expenditure/Domestic Production	15	12.5	15.9	14.5
Capital Expenditure /Domestic Production	9.2	9.1	6.2	6.3
Foreign Grant /Domestic Production	4.4	3.4	2.7	2.1
Trade Deficit/Domestic Production	20	24.1	25.22	28.2
Remittance income/Domestic Production		18.5	23.4	25.5
Export/Domestic Production		4.7	4.8	4.5
Import/Domestic Production		28.8	30.1	32.7
Budget Deficit/Domestic Production		3.6	3.5	3.8

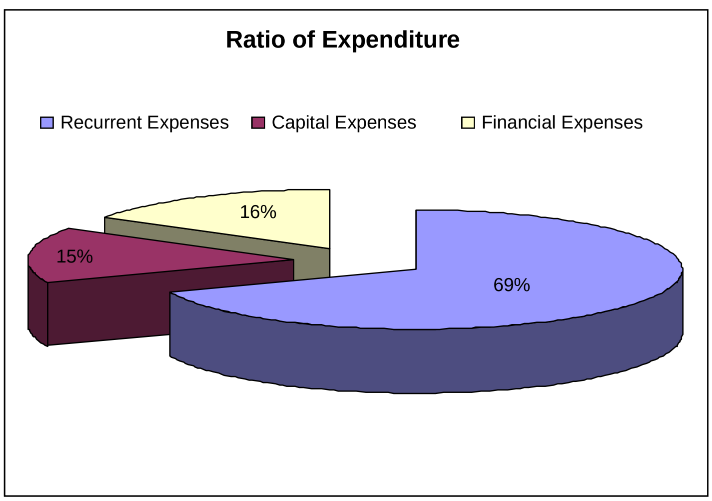
When comparing to GDP, the total expenditure and current expenditure represent 21.5 and 14.3 percent respectively. The target capital expenditure limit of 9.2 percent of GDP has not been maintained. Foreign grant has declined from 3.4 percent to 2.1 percent. Although trade deficit was planned to be maintained in the limit of 20 percent of GDP, it has grown up to 28.2 percent. Pressure on price rise has increased due to failure to maintain inflation rate at 7 percent of target which has grown up to 9.26 percent. Dependency on income from remittance has been increasing. Recurrent expenditure has been rising whereas capital expenditure is declining. Import has been rising significantly whereas export is declining. As a whole, the targets set for main economic indicators for the plan period have not been achieved.

3. **Income and expenditure position -** According to the Financial Comptroller General's Office, the income and expenditure situation of the government for the last three years is as follows:

(Rs. in million)

Particulars	2067/68 (2010/11)	2068/69 (2011/12)	2069/70 (2012/13)	
			Projected	Actual
Revenue				
Tax revenue	17,27,78	21,17,22	25,03,74	25,92,14
Indirect tax	12,41,23	15,39,52	18,26,96	18,78,07
Direct tax	4,86,55	5,64,47	676,78	7,14,07
Non-tax revenue	2,55,98	3,52,64	3,92,31	3,87,27
Principal returned	14,43	1,87	43,95	7,55
Total revenue	**19,98,19**	**24,71,74**	**29,40,00**	**29,86,96**
Foreign grant	4,59,22	4,08,10	4,69,89	3,52,30
Foreign loan	1,20,75	1,10,83	2,58,35	1,19,69
Internal loan	4,25,16	3,64,18	3,80,00	1,90,43
Total income	**30,03,33**	**33,54,85**	**40,04,29**	**36,49,38**
Expenses				
Recurrent expenses	17,02,57	24,34,60	27,90,11	24,74,55
Capital expenses	17,02,95	5,13,91	6,61,34	5,45,98
Financial expenses	10,78,47	4,43,16	5,96,79	5,65,84
Total expenses	**29,53,63**	**33,91,67**	**40,48,24**	**35,86,38**
Savings (deficit)	**49,68**	**(36,82)**		**63,00**

3.1 Recurrent expenditure has increased by 45.34 percent in 2069/70 (2012/13) compared to 2067/68 (2010/11) whereas capital expenditure has decreased by 67.94 percent. Improvements were not seen in the productive activities including the construction of infrastructure and employment generation due to the decline in capital expenditures.



3.2 The ratio of recurrent, capital expenditure and the financial expenditure was 69, 15 and 16 percent respectively which is shown in the figure. Inflation has also increased because major portion of government expenditure was used to meet recurrent expenditures. Although tax revenue in the last three years increased by 50 percent, direct tax revenue increased by only 46.76 percent. In the same period, indirect tax revenue increased by 51.3 percent.

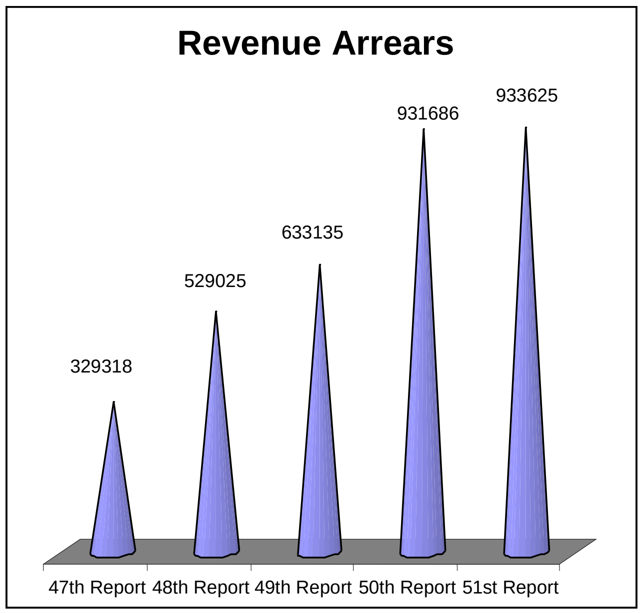
3.3 Foreign grant has been declining since last three years. In 2067/68 (2010/11), Rs. 45 billion 922 million was received as foreign grant which is decline by 22.28 percent and only Rs. 35 billion 229 million was received in 2069/70 (2012/13).

Overall analysis of the status of income and expenditure of government revealed that there is a need to control recurrent expenditure, increase capital expenditure, increase the share of direct tax revenue and increase the utilization of foreign aid.

4. Pension Liability - In the absence of contributory pension fund, the financial burden of government regarding pension has been increasing every year. In the last three years, pension expenditure has increased by 81.66 % from Rs. 10 billion 74 million in 2067/68 (2010/11) to Rs. 18 billion 300 million in 2069/70 (2012/13). Government should introduced the concept of contributory pension system considering the fact that expenditure for pension stands at 6.13 % of the total revenue and 7.4% of the recurrent expenditure. Otherwise expenditure shall continue to increase further in future and the government will face a situation that it will not be in a position to bear the liability.

The overall financial situation of the state is not positive as it has not been able to control recurrent expenditure and increase the capital expenditure, rising government liability in the future, unable to collect the revenue arrears increassing imports and declining exports, increased dependency on remittances and the high rate of inflation.

5. Revenue arrears - On the basis of statement received during the audit, revenue arrears up to the year 2069/70 (2012/13) was Rs. 93 billion 362 million. Compared to the figure of last year the arrears has increased by 27.6 percent. Value added tax (VAT) arrears Rs. 9 billion 520 million has not been included in the government revenue record. Total arrears revenue shall stand at Rs. 102 billion 882 million if this amount is also included. The status of total revenue arrears has been presented in the figure below.



▪ Accurancy and Transparency of Transaction

6. **Consolidated Fund** - The followings fact were noted in the financial statement of the consolidated fund (CF) presented by the Financial Comptroller General's Office (FCGO).

6.1 The financial statement of the consolidated fund has not been prepared in compliance with the Cash Based Public Sector Accounting Standards approved by the Government of Nepal on 30 Bhadra 2066 (September 15, 2009).

6.2 There is a discrepancy of Rs. 1 billion 211 million in revenue amount shown in the financial statement of consolidated fund because the statement shows revenue of Rs. 297 billion 942 million whereas the audit noted only Rs. 296 billion 738 million. On the appropriation side, it showed expenditure of Rs. 358 billion 638 million whereas audit has noted Rs. 359 billion 355 million. There is a difference of Rs. 717 million due to non-inclusion of grant and direct payment made by donors from loan.

6.3 Consolidated Financial Statement reported that total foreign loan receipt during this year was Rs. 11 billion 592 million whereas the Main Financial Statement showed Rs. 11 billion 969 million. Nepal Rastra Bank (NRB) showed only Rs 9 billion 542 million in its Dhukuti Hisab (Revenue Accounts). Reconciliation account has not been prepared to reveal the difference of Rs. 2 billion 50 million shown by the two offices.

6.4 The Consolidated Financial Statement presented by the FCGO showed an income of Rs. 36 billion 714 million from foreign grant. The Main Financial Statement presented by the FCGO showed that Rs. 35 billion 229 million was received as foreign grant whereas Nepal Rashtra Bank (NRB) showed only Rs. 29 billion 515 million. However, reconciliation statement was not prepared to reveal such differences.

6.5 The Main Financial Statement showed saving of Rs. 6 billion 302 million whereas the Consolidated Financial Statement showed saving of Rs. 7 billion 208 million. The central Dhukuti Hisab (Revenue Account) of NRB showed a saving of only Rs. 184 million. Reconciliation statement has not been prepared to reveal the differences observed in those three statements.

6.6 In accordance with the Article (90) of the Interim Constitution of Nepal 2063 (2007), all kind of revenue received by the government except Guthi Revenue has to be deposited as income in the Consolidated Fund. According to the Article (91) all expenditure incurred from the Consolidated Fund should be in accordance with the Appropriation Act Foreign loan and grant of Rs. 1 billion 863 million received during this year for 11 projects including the Air Transport Capacity Enhancement Project and the commodity aid equivalent to Rs. 51 billion 970 million received for two programs has not been recorded as income and expenditure in the Consolidated Fund.

All income and expenditure are not included in consolidated fund. The revenue amount is deposited separately to create fund and spending from outside the budget and the tendency of avoiding audit for the technical assistance and foreign aid has adversely affected the transparency .

7. **Operational Fund -** This year three entities established Operational Fund of Rs. 4 billion 435 million which included the Election Commission Rs. 4 billion 435 million, the Kathmandu Valley Drinking Water and Sanitation Project Rs. 90 million and the Police Headquarter Rs. 385 million. The system of creating such fund from unspent balance of budget appropriation is against the principle of appropriation. This does not provide true view of the Consolidated Fund of the government.

8. **Value Added Tax (VAT) Fund -** This fund was created in accordance with the clause 51 of the VAT Regulation 2053 (1996). This year the fund received Rs. 40 billion 459 million from Custom Offices and Rs. 7 billion 107 million was paid as VAT refund and balance Rs. 33 billion 432 million was deposited to the Consolidated Fund.

All collected amount should be deposited in to the revenue account of the government and if needed to spent or refund that should be incurred from budget appropriation. However, some portion of collected revenue has been spent without depositing in the Consolidated Fund. Thus, income and expenditure have not been reflected true picture, such expenditure have not been discussed in the Parliament and not even included in the Central Financial Statement of the government. This hinders in providing true view of the financial transactions of the country.

9. **Customs Fund Account** - This fund has been created by opening Kha-11 Group account for the purpose of depositing the amount received as per Customs Act and Finance Act. This account should be made nil by transferring any remaining amount to the Single Deposite Account. In contrary to the provision of respective act, four Custom Offices had kept the balance of Rs. 779 million in that account at the end of the fiscal year.

10. **Unaudited Foreign Aid** - All money received by the government including all kinds of foreign aid should be included in the budget, accounted for and their statement should be submitted to the OAG for the audit. However the documents relating to Rs. 3 billion 325 million received as foreign aid by 79 offices under 8 ministries were not submitted for audit.

11. **Technical assistance -** The sectorwise details of the use of technical and other assistance estimated to be equivalent to Rs. 84 billion 481 million submitted to the Legislature-Parliament were not provided. This assistance was to be received under 95 agreements to 25 ministries for 250 programs. Out of this amount, there is no details of entity that will receive assistance equivalent to Rs. 277 million under the 95 agreements. As Responsible Accounts Officer failed to include the statement of technical assistance in the Central Financial Statement as required by the Article 14 (2) of Financial Procedures Act, 2055 (1998), the statement did not provide true and fair view of income and expenditure. As financial statement and accounts was not submitted by concerned agencies, audit of technical assistance has not been conducted.

12. **Other assistance** - Article 10, sub-article (4) of the Financial Procedures Act, 2055 (1998) requires that the statement of expenditure of all kinds of assistance received from any source and stated in the budget should be prepared by the concerned office. OAG has conducted audit of Rs. 125 million in two programs of two line ministries which was not stated in the estimate of expenditure and the statement of technical and other assistance. This amount was not included in the Central Financial Statement. Although a number of government offices are receiving such assistance, they have not submitted to audit.

▪ Public Debt and Guarantee:

13. **Per capita Debt -** According to the statement of FCGO, total accumulated debt liability of the Government of Nepal (GoN) in 2069/70 (2012/13) is Rs. 545 billion 314 million. In comparing to last year the total debt has increased by 3.63 percent. Total debt is 32.06 percent of the GDP which Rs. 1701 billion for the year 2069/70 (2012/13). On the basis of total population of Nepal 27 million as published by the Central Bureau of Statistics (CBS), the per capita debt liability increased by Rs. 466.25 in year 2069/70 (2012/13), and per capita debt liability has grown up to Rs. 20,000.

> Public debt management of the governemnt is weak due to lack of proper documentation of loan investment and incapcity to collect principla and interest the loan, per capita burden of loan grown up to Rs.20,000, the government has to guarantee the loan to the institutions which has poor repaying capacity.

14. **Overdue Principal and Interest -** Principal and interest to be recovered from corporate bodies continue to rise and amounted to Rs. 51 billion 825 million. Corporate bodies that owe this amount also include the institution which were abolished, sold, contracted out on the basis of rent, lost their existence and remained inactive.

15. **Guaranteed Loan** - According to Clause 4(1) of the Loand and Guarantee Act, 2025 (1968), the Government of Nepal can provide guarantee only in case of development projects of the government and to purchase new aircraft to the Nepal Airlines Corporation. As per the decision of the GON, government had provided guarantee to the Nepal Oil Corporation (NOC) in an amount of Rs. 5 billion (Rs. 1 billion from the Employees Provident Fund and Rs. 4 billion from the Citizens Investment Trust. Statement shows that government has made available Rs. 18 billion 780 million to the NOC as of 21 Poush 2070 (January 5, 2014) from these two institutions. Similarly, government has not realized principal and interest which amounts to Rs. 2 billion 44 million provided to different 25 corporate bodies including Gorakhkali Rubber Udyog. According to the existing law, the government is not allowed to provide guarantee to these organizations.

▪ Budget Discipline

16. **Excess Budget Expenditure -** Clause 35(2) of the Financial Procedures Regulation 2064 (2007) specifies that any expenditure should be incurred only in there is an approved budget, for specific purpose and there is a balance to cover the expenditure amount. But this year, Rs. 9 billion 885 million has been spent under 28 heads in excess of budget. Expenditure is incurred in excess to appropriated budget shows that, budgetary discipline has not been maintained.

17. **Budget Transfer or Virement** - Article 8 (1) of the Financial Procedures Act 2055 (1998) and clause 40 of the Financial Procedures Regulation 2064 (2007) specifies that

the Ministry of Finance (MOF) can transfer budget within specific limit from one budget heading /sub-heading to another budget heading/sub-heading. The following cases reveal that budget transfers were not in compliance with act and regulation.

17.1 Amount of Rs. 52 billion 521 million reduced from 236 budget sub-headings and the same amount was added to 514 sub-headings. Such addition and deduction of budget was 12.97% in average of the total estimated expenditures. Out of the total amount Rs 47 billion 234 million appropriated to 34 ministries/entities for capital expenditure, the amount of Rs. 15 billion 104 million (31.98%) was added from the budget transfer.

17.2 As per the statement received from the FCGO, Rs. 279 billion was appropriated to 41 ministries/entities. These ministries/entities received Rs. 26 billion 136 million (which ranged from 0.02 to 1,341 percent of budget appropriation) through budget transfer. Similarly, 39 entities received Rs. 15 billion 292 million from budget transfer (ranging from 0.01 to 6,313 percent) which had budget appropriation of Rs. 66 billion 135 million.

17.3 Rule 35 (2) of the Financial Procedure Regulation, 2064 (2007) specifies that budget can be disbursed only when it is included in the Appropriation Act. But it was noted that the MOF has transferred and disbursed Rs. 4 billion 796 million at the end of fiscal year through transfer to 10 different projects and institutions including feasibility study of the Budhi Gandaki Reservoir Project, Kathmandu Valley Drinking Water Management Board and others without considering the situation to spend the budget and also to the programs that were not approved. Such disbursement at the end of the year to increase the size of budget violated budget discipline.

> Fiscal discipline has not been ensured as evidenced by the following observations: (1) increased practice of spending more than approved budget, (ii) making budget transfer against budget principle, (iii) incurring expenditure in the situation of negative net budget from even after transfer, (iv) not seeking reimbursement on time from donors, (v) appropriating bulk amount under contingency heading and the Ministry of Finance distributing such budget, (vi) not appropriating required amount in budget, and (vii) practice of spending without making provision in budget.

17.4 Budget speech of the Finance Minister on 2069/12/27 (April 9, 2013) stated that the disbursement and expenditure made earlier is already included in the budget. Therefore, transfer made before 27 Chaitra (April 9) cannot be treated as virement to establish net budget. However, the FCGO has shown virement of Rs. 10 billion 963 million which was transferred earlier than that date.

17.5 Article (8) of the Financial Procedure Act, 2055 (1998) specifies that the MOF can transfer budget within specified limit from one budget heading to another heading if there is saving on appropriated budget. MoF disbursed Rs. 2 billion 60 million and same amount was spent even when the net budget was negative. This amount was transferred to constituent assembly election, contingency, regular and development expenditure headings.

18. **Reimbursement -** Clause 37(5) as per the Financial Procedure Regulation, 2064 (2007) requires that the Responsible Accounts Officer should monitor and determine whether reimbursement was requested in a timely manner and submit the annual statement of reimbursement. Last year, the grant amount to be reimbursed was Rs. 16 billion 88 million. This year it increased by 29.13% and reached to Rs. 20 billion 776 million. Similarly, foreign loan amount to be reimbursed in last year was Rs. 6 billion 66 million which increased this year by 32.29 percent and amounted to Rs. 8 billion 959 million. Delays in requesting and receiving reimbursement has increased the burden of expenditure to government and account had to be adjusted by making transfer of resources.

19. **Contingency Expenditure** - Clause 35(2) of the Financial Procedure Regulation, 2064 (2007) requires that budget should be released only within the limit set by approved budget. But MoF, made a provision of substantial amount under the contingency heading, and disbursed Rs. 8 billion 958 million by making decision repeatedly to new and added 497 programs. The practice of incurring expenditure by making appropriation on contingency heading should be monitored and controlled.

20. **Bulk Budget –** Twenty four District Development Committee (DDC) offices segregated the budget and plans approved by the Council and incurred the expenditures of Rs. 324 million in 647 programs on the basis of decision of single board. Non-compliance with the 14 phases established criteria for prioritizing and selecting programs results deficit of fund to invest in requested project. This practice of provisioning bulk budget and allocating programs on individual decision should be brought into end.

21. **Deficit Budget -** In case of the Janatako Tatabandha Field office, Kanchanpur (People Dam project) project completion will require more than 72 years if the current senario of budget disbursement and expenditure get continued. It was estimated that total cost will be 2 billion 151 million to complete work in fiscal year 2083/84 (2025/26). In this context, annual expenditure to be incurred should be Rs. 200 million each year, however the maximum amount spent until now is only Rs. 30 million.

▪ Compliance with law

22. **Illegitimate exemption -** Annex-1 of group 11 of Article 24 of the Financial Act 2068 (2011), stated that the machineries and equipments, their spare parts, penstock pipes or iron plates required for Hydro Electric Project shall be eligible for VAT exemption in import if not manufactured in Nepal. Article 15 of the same act also stated that only one percent custom duty shall be charged on those materials. ACSR Bear Conductor worth Rs. 736 million imported by Nepal Electricity Authority (NEA) and private business entrepreneur from Biratnagar and Birgunj Customs Office was ccleared for import by charging only 1% custom duty and VAT was exempted under the recommendation of Department of Electricity Development. According to Financial Act 2068 (2011), those goods cannot be allowed to import with VAT and custom duty exemption since such

conductors are manufactured in Nepal. As illegitimate exemption was allowed, Rs. 212 million less revenue was collected.

Failure to comply with law due to non-collection of revenue as per law, allow illegitimate exemption, allow increase in cost more than specified in law, incur more expenditure in contingency, not depositing government money in the Consolidated Fund, non-deduction of tax on remuneration, non-clearance of bank guarantee in specified time, reduce tax liability by showing interest free loan without the evidence of legitimate source and not maintaining capital fund as instructed by Bank.

23. **Bank Guarantee:** It was noted that different industries that imported raw materials on the basis of bank guarantee from Birgunj Customs Office have not manufactured and exported finished product. Bank guarantee has not been cleared since 2008 due to failure to export finished goods. As provision of the Rule 10 of the Customs Regulation 2064 (2007) relating to export of goods manufactured from imported raw materials within specified time was not complied with, Rs. 271 million custom duty on the imported raw material with charging additional 25% had not been recovered.

24. **Excise Duty -** According to Article 3(Ka) -3 of the Excise Duty Act, 2058 (2001), excise duty paid only on the quantity of raw materials which were used to manufacture finished product can be deducted from the excise duty to be paid in the export on finished goods. As per clause 6 of the Excise Duty Directives 2068 (2011), excise duty paid for packaging materials cannot be credited. The amount Rs. 77 million excise duty was less recovered from eight tax payers because this amount was credited in contrary to the provision of Excise Duty Directive.

25. **Capital Gain Tax -** According to the Income Tax Act, 2058 (2001), Article 2 da (4), capital gain tax should be collected if a natural person does transaction of house and land in excess of Rs. 3 million. It was noted that during this year 20 Land Revenue Offices including Jhapa, Saptari, Dhanusha, Bara, Parsa, Kathmandu, Bhaktpur, Lalitpur have collected less capital gain tax equivalent to Rs. 44 million.

26. **Diplomatic Missions -** This year 32 Diplomatic missions and Embassies under the Ministry of Foreign Affairs (MoFA) did not deposit Rs. 1 billion 27 million on revenue in the consolidated fund which was retained in the form of cash as at Ashadh 2070 (July 2013). Similarly, Rs. 21 million less tax was collected from salary and foreign allowances of staff of diplomatic missions which is not in compliance with the provision of Income Tax Act, 2058 (2001).

27. **Salary Expenditure -** Diversity was noted in the payment of salaries paid to the Ambassadors appointed and working in the foreign Embassies and Missions in different countries. Payment was made at par with the salaries of Secretaries and Chief Secretaries if they hold ambassador positions at the time of their tenure, whereas Joint Secretaries

were paid at par with the salary of that level. There is a need to establish uniformity by making changes in law.

Cabinet decision clearly states that staff members are eligible to receive family allowances only when family members are living together with staff members. But, Rs. 60 million was paid this year to the staff members of 24 diplomatic missions without the evidence of presence of family members with them.

28. **Contingency -** Eighteen District Development Committees have incurred contingency expenditure Rs. 13 million more than it can be allocated from total amount of capital investment as specified in the Local Bodies Resources Mobilization and Management Directive, 2069 (2012). It was found that the Ministry of Physical Infrastructure and Transport had incurred contingency expenditure of Rs. 617 million without maintaining relevant records. The practice of incurring expenditure in excess of limit set by directive should be controlled by maintaining record.

29. **Lump sum Agreement -** According to the Public Procurement Regulations 2064 (2007), Annex -4 (kha) lump sum agreement can be made for the construction of bridge structure. But Article 55(2) of the Public Procurement Act does not allow price adjustment in such agreement. The offices under the Department of Roads have categorized the tasks related to bridge construction in 5 to 7 activities such as drawing design, environmental studies, substructure and super structure, approach road, insurance or river protection. As lump sum amount is mentioned for sub structure and super-structure which accounts 80 to 85 percent weightage of the total cost estimate, it appears that that these two are to be performed together. It was noted that a total of Rs. 128 million including Rs. 86 million for 6 bridges paid by the Bridge Project and Rs. 41 million for 3 projects paid by the Hulaki Rajmarg Project, Hetauda in contrary to the legal provision. Signing agreement to make payment of price adjustment is not in compliance with law because the concept of lump sum assumes that all kinds of risks and liabilities related to lump sum agreement lie with the contractor.

30. **Local Development Fee -** Budget speeches of the past years made a provision of depositing all local development fees to the Consolidated Fund and to release the required amount following the principle of appropriation with the objective of bringing the fee in the purview of budget. However, the balance Rs. 148 million of the year 2066/67 (2009/10) was not deposited in the Consolidated Fund. This year also a balance of Rs. 85 million remained after incurring expenditure was not deposited in the Consolidated Fund. Such amount should be deposited in the Consolidated Fund.

31. **Expenditure on Other Purposes -** Article 27 (1) of the Financial Procedures Act, 2055 (1998) has a clear provision of recovering the amount of expenditure incurred and also take departmental action against responsible person in case it was noted that the amount received by offices was not spent on the purpose specified. This year, audit noted that 30

offices under six ministries incurred an expenditure of Rs. 27 million for other the purpose of 61 offices/entities.

32. **Capital Fund -** The Rashtriya Banijya Bank classified as category A financial institution has not complied with the instruction 1.1 issued by the Nepal Rashtra Bank in relation to the adequacy of the Capital Fund. The instruction requires that the minimum primary capital fund should be 6 percent. However, the bank has maintained the capital fund Rs. 905 million which represents only 1.51 percent.

33. **Board Member's Borrowing -** Article 11 (kha) of the Income Tax Act, 2058 (2001) has a provision of seeking the source of income for investment other than hydro power projects of national importance, industry that provide employment opportunity to more than 300 workers. Quite a substantial amount of interest free money has been borrowed by the tax payers from their Board of Directors stating unsecured credit, advance for share capital etc. It has been stated that such borrowing was taken and returned back as interest free capital and transactions were not made through banks and source of income stated as gold, inherited wealth and sale of land; but there is no reliable evidence to justify the fact.

Study on those matters revealed that one group of tax payer has received interest free loan of Rs.1 billion 303 million in 2 year period from board members without any documents to justify the source of income. This year, other 10 tax payers borrowed Rs. 697 million and nine tax payers returned last year's borrowing Rs. 587 million. Due to absence of enquiry about the source of borrowed fund taken in past, it was noted that the legitimacy of source of income was established to take away money from business in question. Tax liability was not determined by investigating such transaction.

- **Protection and Utilization of Resources:**

34. **Determination of land rent -** It was noted that the land rent was collected as follows from the Guthi Land of Lord Pasupatinath Trust based on classification of land as Abal, Doyam, Sim and Chahar according to Land Administration Act.

S. No.	Name of Tenant	Location	Area of land	Status of Land use	Annual land rent
1.	One person	Kathmandu 9	11 Aana 1 Paisa 2 Dam	Hotel business	12 Pathi Paddy (approximately 30 Kg)
2.	One hotel	Boudha	12 Ropani 13 Aana	Hotel business	11 Muri 13 Pathi Paddy (approximately 560 Kg)
3.	One charity	Kathmandu 7	2 Ropani 1 Paisa 2 Dam	Trader	Rs. 1768
4.	One finance company	Kathmandu 7	1 Ropani 5 aana 3 Dam	Service as occupation	Rs. 1157
5.	One communication company	Chabahil	3 Ropani 12 Aana 2 Paisa	Service as occupation	Rs. 3304
6.	One service center	Boudha	1 Ropani 4 Aana 3 Paisa 2 Dam	Service	1 Muri 5 Pathi 2 Mana 9 Muthi Paddy (approximately 62 Kg)

The Pashupati Area Development Fund has not determined rent on the basis of land used for various purposes such as agricultural, residential, business or for forest. As a result, it was found that the very costly land has been allowed for use at very low rates.

35. **Useless Investment -** Underground Water Resources Committee Branch Office Parsa had spent Rs. 74 million by drilling water pipes for irrigation in 44 locations. Out of these, the system was found to be useless in 11 locations because pipes were filled with soil and gravel. Similarly, Branch Office, Mahottari had drilled pipes in 30 locations but remaining works were not completed. Although water was running through vertical turbine pump in 19 locations all systems have stopped working resulting waste of Rs. 83 million spent to drill the pipe. Pipe drilled by Rupendehi Branch in 12 location and pipe by drilled Siraha Branch in 2065/66 (2008/09) and 2067/68 (2010/11) in 1/1 location were remained useless due to non-completion of additional work for which expenditure incurred as Rs.23 million. Altogether total investment made for underground water Rs. 181 million became useless.

36. **Flow of River -** A contract agreement was signed by Hulaki Rajmarg Yojana Karyalaya, Janakpur with a contractor on 2067/02/31 (June 14, 2010) with an amount of Rs. 358 million to construct a bridge on Bagmati river which links Rautahat and Sarlahi. After completion of the foundation work and sub-structure by spending Rs. 198 million, the river has changed its course by an about 1.5 KM east from the construction site. This has created a situation to choice whether the river should be brought to original course or construct another bridge from where the river is now flowing.

37. **Use of Funds -** There is provision to use the Rural Telecommunication Development Fund by the Nepal Telecommunication Authority under the Telecommunications Policy. The Authority had a income of Rs. 6 billion 18 million and incurred expenditure of only Rs. 268 million for the development, extension and operation of telecommunication service in rural areas. Similarly, Rs.1 billion 728 million collected by the Ministry of Science, Technology and Environment for the purpose of controlling environmental pollution which has not been used. Amount collected for specific purpose should be utilized as per their objective.

38. **Idle Savings -** As per Telecommunication Act 2053 (1996), Nepal Telecommunication Authority (NTA) receives permit and renewal fee of telephone services. NTA received Rs. 40 billion from two service providers as a renewal fee of cellular mobile. The accumulated profit of this organization until last year was Rs. 950 million and due to collection of renewal fee in 2069/70 (2012/13) the profit was increased to Rs. 12 billion 93 million. After receiving the license and

> Encroachment in public property, not receiving reasonable return from property, making investment without proper analysis, significant amount remained idle, and improper management of medicines leading to date expiry are the indication of ineffective use of resources.

renewal fee each year, the saving amount is rising, but the institution is not in a position to use the fund. Thus, it is required to review of existing legal provisions.

39. **Date Expired Medicines -** The National Policy in medicine requires to complete distribution of medicine to the targeted beneficiaries before its date of expiry, and stocking of medicine which should have 2/3 of the expiry period or at least 18 months of expiry period. While carrying out sample examination of Public Health Offices, It was found that 10 district including Dolakha, Kavrepalanchowk, Nawalparasi, Syangja, Mustang, Rukum, Jajarkot, Surkhet, Jumla and Kanchanpur had the inventory of 44 types of price unquoted 3904 thousand date expired tablets and capsules, syrup of SIFRO, Vitamin B, Amoxicillin, Metronidazole, and Benzene which caused losses.

40. **Head Works Without River -** Rule 10 (6) of the Public Procurement Regulation 2064 2007), has the provision for making arrangement of checking design, drawing and other aspects from technical person or group who is one level higher than the person or group preparing the estimate of construction work. It was noted that Central Irrigation Development Division No. 3 Sarlahi paid Rs. 11 million for the construction of head works of Banke Baba Irrigation Sub-Project. While constructing head works, the drawing and design was changed by stating that the construction of pond would be enough as there was only spring water and no river existed. Thus, it was noted that drawing design and approval of cost estimate for construction of head works was made where the river did not exist.

41. **Forest encroachment -** Until this year, 121,234 households in 63 districts encroached 93,283 hectare (ha) forests and built 30,194 houses and sheds and cultivated land. Even though Forest Encroachment Control Strategy 2068 (2011) was issued to control encroachment, it was noted that during this year only 789.5 ha forest was made free from encroachment.

42. **Less Royalty -** It was noted that as per Cabinet decision of 2069/12/32 (April 13, 2013) for limestone extraction @ Rs. 6,000/ha/year in 32 ha area an agreement was made in Kavre VDC of Dang. As royalty was to be paid to Forestry Office for a period of 30 years and mine royalty Rs. 12 / mt of quarrying was to be paid to Department of Mines and Geology. According to the Forestry Regulation 2011 Annex 6, the revenue for limestone is Rs. 3/cft., accordingly at Rs. 68.18/mt. the royalty should be collected for the extracted quantity of limestone. During this year, the amount to be collected was Rs. 29 million, but due to less collection there was a cumulative loss of revenue by Rs. 24 million.

43. **Land Cultivation -** As per Land Acquisition Act 2034 (1977), construction of house, shed, wall etc. or cultivation is not allowed in the government owned land, without approval of the government and if so done, the government can confiscate such property without compensation. In both sides of service road including the inner slope of main canal of Sunsari-Morang Irrigation project, it was found that more than 5,000 houses and

sheds were built. Similarly, in the project compound areas of 13 Bigha, retired government officials, including more than 20 households have used unauthorized government houses and occupied by constructing houses and sheds. Due to encroachment the canal is silted and the regular operation and maintenance work is difficult. Therefore, the settlement should be cleared and government property should be protected.

44. **Properties of the Trust:** As per the provision of Section 4 of the Nepal Trust Act 2064 (2007), any property under the name of the individual or institution within or outside the country can have naturally transfer in the name of trust. It was noted that as per the cabinet decision of 2069/05/11 (August 27, 2012) the process of registration in the name of tenant was initiated for 175 Ropani 11 Aana 1 Paisa land in Kathmandu Valley which was under dual ownership. This process is not in compliance with the Trust Act.

45. **International Travel-** As per the statement received from the Ministry of Science, Technology and Environment, this year 42 officials of different ranks and positions went for 120 international travels without having financial burden to Government of Nepal. Out of such travels, it was noted that the officials who travelled 109 times did not even submit the required travel report. Apart from that, an official who was retired while in international travel, got reimbursement of unauthorized daily allowances, as per the cabinet decision for a period of 17 days after the retirement of the concerned official.

- **Revenue Leakage and Control**

46. **Advance Tax -** In accordance with the Article 87, 88 and 89 of the Income Tax Act 2058 (2001), it is required that tax should be deducted in advance while making payment. However, 852 offices has not deducted advance income tax amounting to Rs. 305 million. Such amount should be recovered.

47. **VAT Credit -** In compliance with the Article 17 of the Value Added Tax Act 2052 (1995), a person registered can deduct the tax paid for the commodity or service related to the transaction of the taxable item from the tax collected. According to the report of the Internal Revenue Department (IRD), total of debit VAT (to be collected) return was Rs. 24 billion 200 million, however, the credit (to be paid) return was Rs. 175 billion 390 million for the fiscal year 2069/70 (2012/13). Compared to the debit amount the credit amount is 7.2 times higher. Additionally, the amount of VAT credit returned is in the increasing trend. Out of the total tax payers registered in VAT, 22% of tax payers have not submitted return, 32 % submitted zero return and 52% have submitted credit return.

The number of tax payers submitted debit return have been decreasing since last few years, but those submitting credit return and their proportions have been increasing. It shows, ineffective and challenging situation for the implementation of VAT. In analyzing on the basis of offices also, the amount of credit return compared to debit return of Internal Revenue Offices Birgunj and Kathmandu-2 was respectively 10.48 and 9.2 times higher. Some of the reasons of increasing credit return amount compared to the debit return of the VAT irrationally are rebate, duplicate bills, claims of credit based on unrealistic stock and lack of capacity of monitoring and follow up by the IRD; as a result effective implementation of VAT remains challenging.

48. **Value Added Tax Gap -** The gap in VAT to be collected and the actual realized as per the VAT Act 2052 (1995) and VAT Regulation 2053 (1996) was 53.2 % in 2062/63 (2003/04) and 47.5 % in 2069/70 (2012/13). On matters pertaining to VAT collection, it was noted that the policy gap and lapses in the implementation of VAT were main reasons for the gap. There has been policy gap due to increased rebates in different commodity and tax refund system as allowed by the Financial Act. Similarly, the reasons of implementation gap were non-submission of actual transaction by registered tax payers, not registered in VAT after crossing the threshold, zero return and increasing credit return on which monitoring and follow up was lacking. Due to these gaps, it is necessary to pay more attention on the overall gap in the VAT.

49. **Accumulated Loss -** There is a system of carry forwarding loss of business or if the tax amount paid by the tax payer is more than to be paid. It was found Information System of IRD that the tax payers with transaction having more than Rs. 20 million had shown total losses of Rs. 18 billion 896 million in the year 2068/69 (2011/12) and such loss was Rs. 32 billion 166 million in the year 2069/70 (2012/13). This shows a tendency of showing losses than profit in the income statement. Such loss amount is increasing each year. As loss carried forward it would have direct effect in the collection of income tax in coming year, the IRD, therefore, should effectively monitor on such losses.

50. **Revenue Exemption:** Article 18 of the Financial Act 2068 (2011), provides the authority to the Government to lower or raise the tariff, tax rates or the fees by making changes and allow partial or full exemption irrespective of provision in existing law. Apart from that, there are provisions for exemption on tax and fees as per the Financial Act, VAT Act, Excise Duty Act and Customs Act. The Ministry of Finance, provided exemption to different 128 entities who imported items like health goods and equipments, vehicles and electronic and solar items whose invoices were in different currencies. It was also noted that there were no records of revenue exemption maintained calculating the amount of revenue loss in respect of different exemption provided by the government.

50.1 There is best international practice of presenting every year headingwise statement of government revenue loss due to revenue exemption under the tax system as an integral part of the income-expenditure statement. The government has not presented such statement. On the basis of information available from different sources including custom data of the Customs Department, this year there was a total exemption of revenue equivalent to Rs. 24 billion 428 million. Similarly Rs. 7 billion 17 million VAT was refunded on Ghee, oil, and mobile and Rs. 517 million VAT adjustment as well as refund was made in sugar. This caused lower collection of revenue by Rs. 31 billion 446 million.

50.2 Based on the fact that while producing oil from grains, the cost of production would be high. In order to increase the competitiveness of such industry, the government has adopted the policy of VAT refund. But most of the industries imported raw edible oil that have completed 5 stages out of 6 stages of oil processing in foreign countries and applied only ordinary processing technique in the country. As a result, industries refund back VAT amounting Rs. 1 billion 300 million. While comparing and analyzing the differences in prices of raw material and processed edible oil the industries have no value added scenario. Such tax payers, by presenting deficit financial statement, have not even paid any income tax to the state. Also when the government policy decision for rebates are made, the assumption was that there should have been decline in the edible oil prices due to the VAT refund. Though there is a provision to examine the price decline by making follow up, and yet, no follow up has been made accordingly.

50.3 With the objective of promoting formal import process of mobile, the system of VAT refund was established. This year Rs. 363 million was refunded for mobile. At present import and sales of mobiles by authorized representative is increasing and most of the mobile producer companies have authorized representative; and also there is no custom duty on mobile, the continuity of refund policy of 60% VAT should be reviewed.

50.4 This year, the refund of the VAT Rs. 517 million of the sugar sold was adjusted. This policy was brought with the objective that farmers are paid fair price to their crop. But no study has been carried out on whether farmers benefited due to this policy or not. Also there is no record of such refund.

50.5 In order to supply the basic food items needed easily and at cheaper price to all, revenue exemption has been given on agricultural and livestock production. There is a provision of not collecting fee and duties in such goods. Accordingly, this year, there has been exemption of revenue by Rs. 5 billion 238 million. No study was made to examine whether there is any effect on the domestic production of crop and livestock due to such exemption.

50.6 There is provision for rebate in VAT in the imported tractors for agricultural purpose. This year the amount of Rs. 629 million was exempted for that

> Revenue leakage has not been controlled because returns are not submitted by the tax payers who are registered in VAT, the number of tax payers submitting credit return compared to the debit return has been seven times higher, the number of taxpayers submitting debit returns has been declined from previous few years but the number and ratio submitting credit return has been increased, increasing cases of revenue exemption, less custom duty collected because of the application of lower rate, not presentation fair transaction by taxpayers, tax not collected as per law, less revenue collected because iron rod and instant noodle was not produced as per norms and non-adoption of international best practices related to tax assessment.

purpose. Due to lack of monitoring and follow up of the use of the tractors imported using rebate facility for agriculture, it is difficult to ensure that the use has been made for agriculture purpose.

50.7 As per the Financial Act 2068 (2011), based on the recommendation of the Alternate Energy Promotion Center (AEPC), there was provision of charging custom duty at 1% and 100% rebate in the VAT in items including equipments required for solar power production and batteries. Tubular batteries have been imported this year from different custom offices with revenue rebate of Rs. 171 million. Tubular batteries are used not only in the solar electric systems but also for inverters. As a result, due to lack of monitoring and follow up it could not be ensured that the rebate provided for the solar energy is properly used for intended.

50.8 As per decision of the Government of Nepal, there is provision of rebate in custom duty purpose and tax in the construction materials imported that are used for projects including those being implemented under foreign aid. Different goods included in the master list of the projects have been imported through different custom points. Due to such exemption the revenue has been lessened by Rs. 182 million. There is no proper recording system and inclusion of such costs as investment costs of the project. There is no system in place to assure that the imported items with such rebates are indeed used in the projects in question.

It is deemed necessary to establish the system of monitoring to analyze and determine whether the objectives of revenue exemption were achieved, goods that were allowed exemption have been used for designated purpose as well as review of revenue exemption system and establish the international practice of presenting the statement of revenue loss due to exemption together with budget speech.

51. **License -** Different countries in the world have separate tariff rates for software license ranging from 5 to 25 %. Nepal has not made separate schedule of tariff. It was found that the Tribhuvan International Airport (TIA), Custom Office allowed the import of software licensed CD by charging only 5% excise and VAT. It is not appropriate to use the tariff rate of CD for software since telecom software comes as installed in the equipment or a number key are used to install software in telecom equipment after their import. There is no rational to use CD tariff rates. As these goods and services tend to be imported in the form of print material, the collection of 20% custom and VAT is rational. Non compliance of the criteria caused less collection of revenue equivalent to Rs. 165 million.

52. **Debt Equity Ratio -** Article 14 of the Income Tax Act, 2058 (2001) allows deduction of amount paid as interest in loan. It was noted that tax payers were found attracted to take loan than injecting share capital. This year while reviewing of sample cases revealed that the loan was up to 253 times more than share capital. Due to over use of borrowed capital the proportion of interest costs increase, profits get squeezed and the tax liability got reduced. Nepal's laws concerning taxes have not clearly specified the ratios of share

and borrowed capital. In this regard, different countries have managed such problem by limiting the ratios of share capital and borrowed capital between 1:1.5 to 3.1 and making the higher ratios as legally unacceptable for tax purpose. In order to reduce the effect on income tax by collecting a low amount of capital and adding interest costs on borrowing, there should be legal provision in line with the international norms on debt equity ratio.

53. **Tax Avoidance Plan** - A trading Company sold 4,28,755 units of share of one tax payer producing light beverages to its Chairperson on 2068/01/13 (26 April 2011) at Rs. 311 million. Despite the fact that millions worth of trading has been done, the company had not submitted any income statement since 2064/65 (2007/08). The shares bought by the chairperson from his own company at Rs. 727/unit, sold at Rs. 1691/unit at Rs. 720 million to one brewery company on 2068/04/01 (17 July 2011) i.e. after 2.5 months were. In analyzing the transaction, that took place between the two parties, as per the Income Tax Act 2058 (2001), clause 35, the act is rated as the attempted to avoid the tax liability, and it was found that such event should be characterized as per act and assess the tax liability. The tax payer, with the aim of minimizing/lowering the tax rate in transacting the shares, and as this was found to be a part of a tax avoidance plan. Thus, the tax to be recovered at 25 % on the gain of Rs. 415 million which is Rs. 104 million however only Rs. 20 million was recovered resulting revenue loss of Rs. 84 million.

54. **Sales not disclosed** - Article (10) of the VAT Act 2052 (1995) and Rule (6) of the VAT Regulations 2053, require that the company who transacts more than Rs. 20 lakh /year in the past 12 months must be registered in VAT. The 157 tax payers who transact millions of Rs. under different Internal Revenue Office are not registered in VAT, and the same have filed return showing less than Rs. 2 million as transaction. Such tax payers were found entering maximum transactions of up to Rs. 60 million but not shown actual transaction, the tax administration has not monitored and made any follow up action. The actual state of affairs is that there has been less collection amounting to Rs. 174 million as value add tax over the threshold amount.

55. **VAT on the Construction of Structure** - Article 8(3) of the VAT Act, 2052 (1995) requires that any commercial structure, building, apartment or shopping complex or similar structures as decided by the department authorities valued at over and above Rs. 5 million, and the work accomplished through unregistered person should be assessed and tax should be collected from the owner of such infrastructure. Companies engaged in the construction of larger infrastructures capitalized or in stock, are found transacting with those which are not registered; and so the VAT that could not be collected from 40 tax payers, when assessed, it was noted that Rs. 496 million and the penalty associated on this amount was not collected.

56. **Norms -** As per the norms of year 2063 (2006) published by the Department of Industry, the input output ratio of steel rod is 94.34 %. There was lower collection of revenue Rs. 3 million by the Internal Revenue Office Simara and Birgunj because the output was lower

than stated in the norms. Similarly, though there is norm of production of 1 kg readymade noodles from 745.5 gram wheat flour, it was found that the taxpayers under the Internal Revenue Office Lalitpur and Bhaktpur had shown less production than stated in norms. The noodle produced was less than norms, thus, the excise duty Rs. 21 million at the rate of Rs. 7.50 per kg has not been taken into account. Such lowered production has made impact on income tax and the VAT too.

▪ Contract Management

57. **Time Extension -** According to Article 56 of the Public Procurement Act 2063 (2007), the extension of contract agreement, can be granted by the concerned official of the government only in situations which are beyond control and other logical reason. It was found that the contracted works by public entities were not completed in time. Out of the 2937 contracts made, 1632 (56%) got time extensions, out of which time extensions up to 50% was made for 535 contracts, 51-100% time extension was given to 516 contracts, and time extension by more than 100% was given to 581 contract cases was seen. Due to the trends of time extension of contracts, the costs of the projects and programs are increasing.

> As the contracted work were not completed on time, repeated time extension was allowed for contract work, contractor not initiating contract work showing irrelevant reasons, changing the drawings and design of bridge, such situations leading to issue of variation orders reveal that contract management is not efficient.

57.1 The Division Roads Office Palpa, has made the agreement of Rs. 112 million to construct of bridge in Kali Gandaki. It has provided third time extension by 36 months; and three year contract period was extended to six year. The Director General of the department has extended time of completion up to 2071/03/04 (June 18, 2014) against the recommended time extension period of 2070/09/24 (December 24, 2013).

57.2 Review of the 13 contracts of two sub-projects under the Melamchi Drinking Water Project revealed that pre-notice was not given on eight contracts as per contract agreement, time extension request not submitted, variation order was not issued, contract was extended ranging from 71 percent to 259 percent and up to six times in one contract without submitting revised work schedule.

58. **Bridge under construction -** The bridge construction work, under the Department of Roads has not not completed in time due to faulty design, dispute on construction site, and not implementation of work by contractors. The construction contractors, have taken advance money, after singing the contract, but have not progressed as per the schedule time period; and in a number of cases there has been damages even in the infrastructure constructed.

58.1 Harkapur-Okhaldhunga Roads Project has made an agreement of Rs. 134 million to construct a Steel truss bridge in Sunkoshi river in 2059/03/09 (23 July 2002) to complete the work until 2063/03/02 (16 June 2006). Design has been changed on 2067/06/04 (20 September 2010) and new agreement amount Rs. 132 million was determined. In seventh time extension contract period has gone up to April 2014. The amount of Rs. 78 million has been paid to the contractor till now. When site visit was made on 2070/06/08 (24 September, 2013) the work so far done was only 2 Abutment and one Pier totaling three sub-structures.

58.2 A contract agreement with one contractor for the construction of Steel Truss bridge at Bheri river and to complete it by 2065/03/28 (July 12 2008) has been made on 2063/02/09 (23 May 2006) with Rs. 30 million. Due to non-completion of the contract work in time, a fourth time time extension has been given until 2070/2/30 (13 June 2013). It has taken 13 months to decide about time extension. The contract work supposed to be completed within 2 years has gone up more by 4 years and 11 months, and yet the work was incomplete.

58.3 In order to construct a bridge in Mohana River, an agreement has been signed in Rs. 130 million with one contractor by the Division Roads Office, Kanchanpur, and the expenditure Rs. 80 million was incurred until this year. There is no clarity on how to access the 204 meter long bridge. It was found that construction work was started without identifying access road to the bridge.

59. **Contract Execution**- In the Eastern Sector of the Mid-Hill Lok Marga, out of the current ongoing 127 contract agreements, 89 contract works are deferred during year. Out of those contract, the construction work of 26 contracts have not been started by Asadh end 2070 (July 2013). Those contractors received the advances of Rs. 60 million. Time of those 37 construction works was extended for a period ranging from 6 to 32 months. However, the progress record of those contracts ranged from 4 to 82%.

For the construction of the 167 Km. long Ghurmi-Chatara road sector, the contract work for 17 out of 20 contracts that was signed in 2068/69 (2011/12) is incomplete. The work is not initiated for the 14 contracts with the allocated budget of Rs. 111 million. The time period for 15 out of those 17 contracts has expired by end of Asadh 2070 (July 2013). The construction work of the road section was found to be stopped, and it was argued that most part of the road lies in the forest area and therefore the ministry of Forest and Soil Conservation and agencies under it has not given any acceptance letter to work there. The period of bank guarantee submitted by the contractor has come to an end and the advance Rs. 21 million was not cleared.

60. **Variation** - The initial contract amount of Keladi Ghat bridge construction which is under the Division Road Office, Palpa was Rs. 127 million and has been increased by 32.1% to Rs.168 million. The decision made to take necessary action to the responsible official involved in contract and to the person who prepared tender document, and taking

initiatives to black list the firm, company or the expert involved in the supervision, and to the concerned wrong designer while accepting variation; however, no action was taken.

61. **Tunnel Contract –** A contract agreement of Rs. 4 billion 289 million was made by Melamchi Drinking Water Development Committee on 2065/11/08 (19 February, 2009) with one International Contractor for the construction of head works and tunnel had been terminated by the committee after the payment of Rs. 520 million untill 2069/06/09 (25 September, 2012). Committee could not receive compensation amount for the losses and the Bank guarantee after the termination of contract, amounting to Rs. 806 million has not been realized so far.

62. **Petroleum Research** - Three contract agreement signed 9 years and 15 years ago with a plan to complete exploration within 4 years have not yet completed. Those explorers have not taken initiatives to extend the period of Bank guarantee, time schedule, budget and the submission of detailed report. Similarly, two contractors who signed contracts on Asadh, 2069 (July 2012) to do similar exploration have not started work as per contract. It is observed that no actions have been taken against these firms according to the agreement. Additionally, land rent tax (Bhu Bahal Kar) Rs. 132 million has not been recovered from the contractor.

▪ Procurement Management

63. **Time of Contract -** Rule 20 (9) of the FPR, 2064 (2007) clearly mentions that the task of approving contract should be completed within the first trimester of each FY. It was observed that out of total 5,139 contracts amounting Rs. 22 billion 920 million under 21 ministries, 85.72% or Rs. 19 billion 649 million with 4,613 contracts were awarded in the second and third quarterly period. Of those contracts awarded in the third quarter 905 contracts amounting to Rs. 4 billion 889 million were awarded in the month of Asadh (June/July); and so doubts are raised to meeting the quality standards of works.

> Procurement management seems weak for the reasons that include selection of same contractor in multiple contracts, allowing User's Committees to undertak complex technical works with cost estimates of more than 6 million, procurement not made on time, direct purchases made by spliting cost estimates, liabilities increased due to cancellation of tender, approval of substantial low bidder compared to the estimated costs resulting non completion of work in time.

64. **Piecemeal Cost Estimates** - Article 8(2) of the Public Procurement Act, 2063 (2007) restricts conversion of a contract into piece of works or services that would put limits to competition in procurement. In contrary to the legal provision, cost estimates were made in 729 pieces of infrastructure construction and procurement of goods which amounting to Rs. 811 million under 13 ministries. As a result, the procurement work was not economical.

65. **Direct Purchase -** According to Public Procurement Regulations, 2064 (2007) Rule 85, there is a provision for direct procurement of construction work amount not exceeding Rs. 5 lakh and direct purchase of goods not more than Rs. 3 lakh. But, 276 Offices under 19 entities made direct purchase of goods, construction works, other services and machinery goods from time to time which amounting to Rs. 1 billion 307 million that limited competition. No justification was provided to procure goods and services by causing limits to competition and against economic and legal norms.

66. **Prequalification of Contractors -** Due to noncompliance discloser provision of the Public Procurement Regulations 2064 (2007), Rule 60 (ka), the resources of one contractor opens and gets evaluated for a number of contract packages at one point of time and contract agreement can be made. However, limited resources cannot be mobilized for all contract works. As a result, due to work load, there is a situation that the contract is not complete within the estimated time. For example, the Division Road Office, Hetauda, has made agreement having cost estimates of Rs. 367 million to complete 7 construction works in two years. There is no possibility of completing all work within time frame.

67. **Approval of Tender Document -** According to Public Procurement Regulations 2064 (2007), rule 65 (2 and 3), there is a provision of asking for clarification by the tender document evaluation committee if the bidder quotes minimum rate, and can accept the quotation by taking 8% of the quoted amount as additional performance guarantee and may reject the quotation if the clarification is not satisfactory. This year, the Division Road Office, Surkhet in 147 contracts amounting Rs. 367 million accepted quotation of less amount up to 86.93%; Division Road Office, Kathmandu in 146 contracts amounts ranging from Rs. 1 million to 10 million with quotation less up to 51.24%; and Division Road Office, Hetauda in 16 contract works amount ranging from Rs. 1 to 4 million with quotation less by up to 65% of the estimated costs and also completion of work was observed. As a result, doubts are casted for public construction works on the reliability of the norms, work rates and cost estimates.

68. **Termination of Contract** - Article 59 of the Public Procurement Act 2063 (2007) has a provision for the termination of contract agreement and its remedy. Armed Police Force Border Security Office, Sindhupalanchowk, publish tender notice; and it was found that the agreement was made with the contractor for the supply of food in minimum at Rs. 2.23 /day /person. After the termination of contract as agreed, without attempting to make a new deal with those who were ranked as second and third in the tender attempt, fresh tender was called and supply agreement of food amounting to Rs. 15 million at Rs. 157.26 /day /person was made. As a result, it was found that in a year the total financial burden to the government amounted to Rs. 15 million.

69. **Users Committee -** According to Public Procurement Regulations 2064 (2007), rule 97, there is provision for taking services of user committees for estimated costs up to Rs. 6

million; and in construction works use of heavy machines is not allowed, and works involving complex technical aspects should not be allowed. In this regard, the following points are noted.

69.1 A number of agreements followed the subsequent completion of construction work, Sunsari-Morang Irrigation Project with Rs. 96 million involving 8 user committees and contracts made 105 times; Water induced disaster Control Division, Morang with Rs. 6.6 million involving one user committee and contract made 2 times; Janatako Tatabandha Program, Field Office Jhapa with Rs. 109 million involving 3 user committees and contract done 51 times; Purbanchal Irrigation Development Division, Jhapa with Rs. 35 million involving 2 user committees and contracts made 8 times; Central Irrigation Development Division, Parsa with Rs. 6 million involving 1 user committee and contracts made 2 times. Time and again agreement was made with repeated specific user group by splitting estimated cost within Rs. 6 to construct a single canal system and structure which is not in compliance to the legal provisions.

69.2 Against the prevailing regulations, it was found that the Offices of the DDC, Solukhumbu, Rasuwa, Rupandehi, Kathmandu, and Kaski contracted out works amounting to Rs. 175 million to 8 user groups; and Dhobikhola Corridor Improvement Project contracted out works amounting to Rs. 253 million to 23 user groups, with the cost estimates that exceed Rs. 6 million. It was also found that in most of the works even heavy machines were used.

69.3 It was found that thirteen DDC Offices contracted out project works requiring complex technicalities such as building construction, black topping of roads and RCC works to user groups and paid Rs. 69 million.

- **Economy**

70. **Load Shedding Minimization -** As per the load shedding minimization Action Plan, 2068 (2011), there is a provision of providing concessional credit rate and up to the period of payment of credit the offer of prevailing posted rate of the power purchase agreement by the Cabinet. But, for 23 projects the concessional credit rate and offer of prevailing posted rate of the power purchase agreement up to the period of payment of credit amounting Rs. 2 billion 799 million has been provided by the ministerial level decision. It was noted that the above decision has raised the liability to government by Rs. 6 billion 269 million. It is not reasonable to offer facilities by ministerial level decision which is required to be made by the Cabinet.

71. **Investment in Inactive Corporations –** As per Directives on Maintaining Economy in Government Expenditures, 2068 (2011), it is mentioned that there will be no investment in shares and loan in public corporations except in cases where such arrangement is made through annual budget. This year, Rs. 1 billion 793 million was provided for salary, allowances and administrative costs by transferring money to miscellaneous

heading for those corporation which are inactive including Nepal Ausadhi Ltd., Nepal Metal Co., Janakpur Cigarette Factory, Gorakhkali Rubber Udyog, and Nepal Orient Magnesite. Cumulative outstanding loan up to previous year to these corporations was Rs. 1 billion 255 million and interest on this amount. Under such circumstances, this year also the loan was provided to those institutions.

72. **Consultancy Services** - As per the Public Procurement Act, 2063 (2007) clause 29(1) (ka) states that if there is a lack of manpower in any public entities to perform the deemed activity, there is provision for procuring consultancy services from any person, firm, organization or company. This year, despite the presence of required type of manpower, the Ministry of Physical Infrastructure and Transport and the Ministry of Urban Development spent Rs.96 million and Rs. 24 million by procuring external consultancy services.

72.1 It was found that in most of the projects implemented under foreign aid, the expenditure in consultancy services ranged from 4.4 to 24.5 % of the total cost of the project. There is a situation of procuring consultancy services even when the services required can be performed by the departmental manpower. The following is the allocated amount for the consulting services.

(Rs. in thousand)

Project	Currency	Total cost estimate	Amount allocated for consultancy services	Percent of the project cost on consulting service
Sub-regional Transport (Services) Improvement Project	USD	24,500	6,000	24.50
Melamchi Drinking Water Project, Sub-project-1	NRs.	23,458,650	3,381,200	14.42
Road Sector Development Project	USD	125,600	12,820	10.20
Kathmandu Valley Drinking Water and Sanitation Project	NRs.	3,211,902	307,250	9.57
Kathmandu Valley Drinking Water Improvement Project	NRs.	11,504,706	506,400	4.40
Second Small Towns Drinking Water Project	NRs.	6,535,520	567,477	8.68
South Asia Tourism Infrastructure Development Project	NRs.	8,311,455	366,795	4.41

As there is no specific policy and standards established on matters pertaining to the expenditure on consultancy services; even for the works of simple nature, there is a growing tendency of procuring consultancy services. As a result, the government expenditure has not been economical.

72.2 There are seven consultancy firms and currently four consulting firms are engaged in the design and supervision of the construction work of tunnel, water processing center and supervision work of Samajik Utthan Program of the Melamchi Drinking Water Project. The total expenditure has been Rs. 3 billion 47 million for the consultancy services from the beginning of the project until Asadh end 2070 (July 2013). The project was commenced since the year 2055/56 (1997/98) and the construction work of the project is getting longer to the year 2073 (2016). As the engaged contractors could not complete their works in time, the period of the project is getting longer, and the need and circumstances to hold consultants without any job which has resulted to burden of over expenditure to the government. As there has been retender of the work of water processing center and tunnel construction work, it is assessed that there will be further more expenditure due to the continued need for consultancy services.

> Situations such as increase in the financial liability of government due to making of decisions at ministerial level in contrary to the requirement of making decision from cabinet, works performed by consultant which can be performed by employees, incurring administrative expenses for the corporations that are inactive, provide illegitimate facilities, delayed supply of goods resulting burden of foreign exchange, destruction and reconstruction of the same graveled road for sewerage due to lack of coordination in work have resulted uneconomical use of resources.

72.3 Instead of paying as per the contract agreement mentioned in the Public Procurement Regulations, 2064 (2007) rule 123, the AIDS and Sexual Disease Control Center has made over payment of Rs. 10 million than agreed to one council on medicines and remuneration.

73. **Burden of expenditure** - It was noted that the road maintenance and camp construction work was sub-contracted with higher rates than agreed in the main agreement made with the original head works and tunnel construction contractors of the Melamchi Drinking Water Development Committee. After the termination of contract agreement on 2069/06/09 (25 September, 2012), the works subcontracted were owned by the Committee and decisions were made to pay the sub-contractors with agreed rates for the two works; there has been extra financial burden of Rs. 40 million. This amount should be deducted from the original contractor and adjusted.

74. **Excess Budget Release:** This year, an over release of Rs. 49 million on teacher's salary was noted in 43 District Education Offices; and in the process of audit Rs. 8 million and after sending preliminary report Rs. 5 million was recovered and the remaining Rs. 35 million is to be recovered. District Education Office, Mahottari has released Rs. 400 thousand as marriage expenses for the daughter of a teacher and Bara has provided Rs. 1 million to one school which was not in record. Similarly, double release of Rs. 6 million has been made by the District Education Office of Kapilvastu, Dhading and Siraha for tiffin and Rs. 10 million by other three offices for scholarship.

75. **Administrative Costs -** According to the Local Bodies Financial Administration Regulations 2064 (2007), certain percentage of internal income can be spent by the DDC for administrative purpose within the appropriated budget limits. However, 58 DDCs

spent more by Rs. 356 million than the allowed limit and so there is an increase in the expenditure. Regarding this the Public Accounts Committee decided on 2069/12/01 (March 14, 2013) to take departmental action for over spending. However, this decision has not yet been implemented.

76. **Excess Benefits -** Rule 257(1) of the Local Self Governance Regulation 2056 (1999) states local bodies are required to make decision on their salary, wages, allowances, and other benefits based on the salary scales of the civil servants. But, 33 DDCs have paid money for the cumulative leaves, festival expenditures, council allowances, resident allowances etc. Such kind of benefits based on the decisions of the Council amounting to Rs. 64 million was not eligible or spent double for the same purpose.

77. **Loss of Gravel** - The road widening work is in its final stage with retaining wall both sides of Dhobikhola under Dhobikhola Road Project. Until this year, the total expenditure was Rs. 616 million. In the initial cost estimates, there was no provision for side drain. But, in the year 2070/71 (2013/14) the Bagmati Savyata Ekikrit Bikas Samiti has started construction work in the Dhobikhola corridor at the cost of Rs. 300 million. The road was graveled without making the provision of drainage in the initial stage of the project. Now dismantling the graveled road of both sides of the river to construct drainage has resulted the investment useless and incurred loss of Rs. 616 million.

78. **Engineer's Facilities -** Facilities of Rs. 22 million has been included in the contract for a driver and vehicle with fuel by the Sikta Project; and amount of Rs. 8 million by Bagmati Savyata Ekikrit Samiti total being Rs. 30 million in contrary to the decision of the Public Accounts Committee. It is not rational to set aside such money in the construction contract to provide facilities to an engineer.

79. **Position Adjustment -** There has been an uneven distribution of teachers. Schools located near to the district headquarters get more number of teachers than allocated and less numbers of teachers are positioned in remote locations due to the inability of the officials to place teachers as per requirement. For example, in different schools of 4 districts of Mechi zone there were more teachers by 1076 and less teachers by 437. The adjustment of teachers by available positions was not possible and to those schools with less teachers than positions and the additional amount that had to be made available was Rs. 14 million for additional cases.

80. **Exchange Loss -** The Police Headquarters, in order to procure items like woolen shirts, pants etc. had opened letter of credit amounting to Rs. 74 million and due to delay in delivery of goods the time extension was made; and while clearing the Letter of Credit advances Rs.86 million was spent. Due to changes in foreign exchange rates, the financial burden to the government was Rs. 12 million.

81. **Bond** - The three scientist officers and 6 technical officers of the Nepal Agriculture Research Council took study leave and proceeded for study for three years; and are

required to serve for 6 years after completion of their study; but did not abide by the agreement. As they agreed to compulsorily serve after completion of the study but did not do so, thus they should return Rs. 5 million salary and allowances and the two way transport cost incurred.

- **Program Implementation**

82. **Target Progress** - It was observed that the zero percent annual progress was made in 844 programs, 0-25% progress in 357 programs, 26-50% progress in 1013 programs, and 51-75% progress in 5725 programs under 28 different entities. Though the Financial Procedures Rules, 2064 (2007) rule 26 specifies that necessary action will be taken to responsible person after reviewing the progress. It was found that no action whatsoever, has been taken by the related institution/ministry or the department for not achieving targets.

83. **Authorization -** In accordance to the Financial Procedures Rules 2064 (2007), rule 23(2), authorization of annual program and expenditure to the concerned office by the concerned ministry shall be given within 15 days of the start of the fiscal year. This year, authorization for Rs. 9 billion 489 million is given to the Offices and projects only in the month of Asadh 2070 (June/July 2013). Programs are affected due to failure in sending the authorization for expenditure in time to the concerned offices as per legal provision.

84. **Year end Expenditure** - In the month of Asadh (July), 39 offices under the different ministries/entities spent Rs. 20 billion 353 million which was 37.28% out of the total allocated capital budget of Rs. 54 billion 598 million. The practice of incurring high amount of capital expenditure in the month of Asadh (July) will yield very poor quality of work, such practice should be controlled.

85. **National Pride Project**- As per the target set in the periodic plan, some national pride project have been implemented with highest priority for expanding physical infrastructure and offer service to the people. Progress of some of the national pride projects is given as follows:

(Rs. in million)

S.No.	Name of the Project	Initial Year (BS)	Completion Year (BS)	Estimated Total Cost	Cost to date	Physical Progress in %
1	Mid-Hill Highway Project	2064/65	2074/75	33372	4978	14
2	Hulaki Highway Project	2066/67	2074/75	35800	3580	28
3	Sikta Irrigation Project	2059/60	2070/71	12800	7898	57
4	Rani Jamara Irrigation Project	2066/67	2074/75	12638	2303	17
5	Babai Irrigation Project	2045/46	2070/71	3770	2859	55
6	Gautam Buddha International Airport, Bhairahawa	2068/69	2075/76	9135	0	0
7	Pokhara New Airport	2067/68	2071/72	20645	80	Not clear
8	Melamchi Drinking Water Project Sub-project-1	2055/56	2072/73	23459	8965	49

Note: The basis to determine total project cost estimate of S.N 6 and 7 is at the exchange rate at the end of Ashadh (July) US$ 1 = Rs. 95.70.

85.1 Second International Airport, Simara is included in the national pride project and yet not implemented by approving the program and budget. The feasibility study of this project has been carried out, but the work has not moved ahead due to uncertainty in the modality and selection of investors.

85.2 The works of Gautam Buddha International Airport and Pokhara New Airport was targeted to be commenced from 2068/69 (2011/12) and 2067/68 (2010/11) with the estimated costs of Rs. 9 billion 138 million and Rs.20 billion 645 million respectively. So far there has been no expenditure made in these projects. Under such circumstances, there is no possibility of completion of works in the targeted time.

85.3 The completion of Melamchi Drinking Water project is targeted for the year 2072/73 (2015/16). However, it was initiated from the year 2055/56 (1998/99), the physical progress of this project is only 49%. In analyzing the situation based on the progress made, there is no possibility that it would be completed in time. Even though the construction work of the tunnel gets completed, no possibility is seen that the users will get benefit due to the slow and minimum progress in laying the pipe lines.

> Project implementation has not been satisfactory due to lack of capacity to implement despite announcing projects of national pride, conflict at local level and the absence of clear implementation modality. Project implementation has also been affected due to delays in issuing authority as per approved programs. There is uncertainty in achieving results due to absence of monitoring system in a number of programs.

85.4 Sikta Irrigation Project and Babai Irrigation Project were initiated in the years 2059/60 (2002/03) and 2045/46 (1988/89) and targeted for completion is the year 2070/71 (2013/14), but, the progress until this year was 57 and 55 % respectively. On the basis of physical progress of the projects achieved in the eleventh and 26th years of initiation, the results of these projects of national pride remains uncertain.

85.5 Target was set for the completion of the Madhya Pahadi Lokmarga with an estimated budget of Rs. 33 billion 372 million which was started in the year 2064/65 (2007/08) and completion is targeted in ten year period by the year 2074/75 (2017/18). Critical analysis of the circumstances show that there is no possibility that this project would be completed by 4 years from now, as expenditure of Rs. 4 billion 978 million was made and 14 % progress made in 6 year time period after initiation of the project. . Slow progress is noted due to dispute in the track opening, and non-completion of works by contractors in time.

85.6 The Rail and Metro Development Project was included under the projects of national pride and expenditure of Rs. 2 billion 200 million for survey work of its part was made, however, the work is not progressed in a planned way by preparing detailed project report.

85.7 Hulaki Rajmarga Project was started in the year 2066/67 (2009/2010) and was expected to complete in 2074/75 (2017/2018); yet the physical progress until now is only 28%. The implementation is slow due to problems including land acquisition and alignment controversy in the national parks.

85.8 The implementation status of national pride project including Sapta-Koshi High Dam Project, Pancheswor Multipurpose Project, Budhi Gandaki Hydropower Project and Nal Singhgad Hydropower Project has been slow because they were not implemented after preparing detailed project reports, undertaking works in a planned manner and only small amount of budget appropriation was made to those projects.

On the whole, the implementation status of national pride project has not been satisfactory. These projects will not be completed on time and yield targeted results because time bound implementation modality was not prepared. Other hindrances such as lack of implementation capacity and dispute in local level and similar type were observed. Additional efforts shall be required to complete high priority projects. Attempts should be made by all means to complete them in time and harness the results.

86. **Drawing and Design -** Rule 22 of the Financial Procedures Regulation 2064 (2007) has made the provision for preparation of detailed survey and drawing design. However, this year, Rs 1 billion 49 million was allocated under the Kathmandu Valley Roads Improvements project to construct and extend 11 roads without any required survey, drawing and design.

87. **Bridges not Constructed -** In the 2.6 Km section of Maitighar-Tinkune the 8 lane road extension is ongoing but bridges are not accordingly constructed in the Dhobikhola and Bagmati River. As a result, smooth commuting has not been possible. Vehicles entering through 8 lane require to accommodate suddenly themselves in the narrow bridges has resulted difficulties in commuting, traffic jam and has to face the risk of accidents.

88. **Coordination -** According to the Public procurement Rules 2064 (2007) rule 6(3), the public institutions should not enter into the action of procurement of contract services without having clear site for construction. The construction work is being impeded due to delays in transfer of drinking water pipes, telecom cables, optical fibre cables and electric poles and cable lines even after contract work has been awarded under the Maitighar-Tinkune, Dhumbarahi-Galfutar, Lainchaur-Budhanilakantha, and Jai-Nepal-Krishna-Pauroti Road projects.

89. **Child Nutrition -** Article 27 of the Public Procurement Act, 2063 (2006) requires that those tender/quotation should be accepted which are lowest. The children are deprived of the supplemental/nutritious food as the tender quotation floated with estimated cost of Rs. 505 million for the procurement of micro-nutrition powder, out of the two tender

submitted, lowest costs was Rs. 277 million. The tenders was cancelled by the Children Health Division of the Health Services Department claiming that the program will be implemented only after carrying out the impact evaluation of the previous similar program. As a result, there has been adverse consequence on the program for minimization of mal-nutrition in children.

90. **Cash Incentives -** As per the Cash Incentive Directives, 2070 (2013), with the objective of promotion of export and reduction of trade deficit, 1-2 % of the foreign currency received and collected in the commercial Banks is provisioned to be given as cash incentive to those industries who export the specified goods to the third countries. The government has given Rs 248 million as subsidy for this purpose through NRB without any analysis of rise in export.

91. **Budget Transfer -** According to the Financial Procedures Rules 2064 (2007), rule 78, states that by the end of the fiscal year, with a objective to non freeze the budget, 13 DDC offices transferred Rs. 67 million in the District Development Fund. The unspent money of Government budget cannot be transferred. Such money should be deposited in the government revenue.

- **Monitoring**

92. **Affiliation -** It was noted that, out of 37,539 organizations affiliated with the Social Welfare Council, only 573 (1.5%) are active and program agreements were signed for Rs. 829 million. Though 98.5 % organizations are inactive, their affiliation status has not been cancelled. International organizations, who have entered agreements with the Council, their liability is to submit the 4 monthly statement of bank deposit. However, it was found that no action was taken against noncompliance with this provision.

93. **Utilization of Loans/Borrowing -** The Youth Self Employment Fund , without setting up any standards, has invested up to Rs. 50 million through some cooperatives; and this year it has not collected capital and interest amount of Rs. 66 million from 394 organizations. The business is not functioning as per the project proposal and not found to be engaged as per its objectives due to weaknesses in effective monitoring.

94. **Affiliation -** The Ministry of Education has yet to give affiliation to six colleges for those medical colleges who have shown intention to operate such colleges. Fourteen out of thirty-one medical colleges are in operation in Kathmandu and Lalitpur district only. It was found that there was no decision about the fee to be collected by them.

The Council on Technical Education and Vocational Training (CTEVT) from 2050 to 2070 Asadh (1993 to 2013 July), had given temporary affiliation without giving permanent one to 408 institute for Diploma level and 229 institutions for operating Technical Praveshika class and has given continuity to renewal each year. While monitoring, the council, this year, it was found that 20 diploma level and 31 technical Praveshika (medium) level programs did not fulfill the minimum requirements. . Most of the organizations who have received approval to operate staff nurse and general medicine programs with 50 bed hospital have not fulfilled criteria, and has very low number of patients in hospitals and no services of specialization.

▪ Returns on Investment

95. **Returns to Investment in Shares -** Out of the total investment of Rs. 115 billion 444 million made by the Government of Nepal in 103 corporate bodies, dividend of only Rs. 10 billion 841 million received from eight corporate bodies. It represents 9.39 % of the total investment in shares made in corporations. No dividend has been realized as most of the corporations are in loss.

96. **Risk Prone Investment /High Risk Investments -** Civil Investment Fund had invested Rs. 1 billion 35 million in Development Banks and Financial institutions which are in trouble. A provision was made at 20 percent per year for the management of risk. Similarly, deposit and interest amounting Rs. 485 million invested under the Army Welfare Fund in 3 Development Banks and 84 financial institutions is in risk.

97. **Non-interest Earning Account** - It was observed that NRB invested its investible amount Rs. 8 billion 511 million in non-interest earning accounts of foreign Banks. As a result, maximum use of available resource to get maximum returns has not been made.

98. **Project Loans -** It was noted that Karmachari Sanchaya Kosh provided a loan of Rs. 237 million as per the decision of its Board of Directors to one Housing Company which was black listed in Credit Information Centre. The total loan limit approved was Rs.1 billion 380 million. However, loan RS. 278 million including principal and interest was outstanding at the end of Asar 2070 (July 2013). As the maturity of the loan provided to that company was already been over and the project is not in a situation to continue, the necessary initiatives should be taken through different measures including the auction of the collateral to recover the loan.

99. **Quality of Education-** It has been mentioned that the percentage of students passing secondary examination from community schools shall increase after the implementation of the Three Year Plan (2010/11-2012/13). During this period the investment made in secondary level education increased from Rs. 26 billion 443 million to Rs. 32 billion 504 million. As the number of students passing secondary examination from community schools dropped from 47.2 percent to 28.42 percent in contrary to the target of the plan, this situation clearly indicates that the return on investment in education has not achieved results.

▪ Acquisition of Resources

100. **Loan and Interest -** A case was filed in the Revenue Tribunal regarding the loan provided to one sugar mill by the Karmachari Sanchaya Kosh. The tribunal gave a verdict

to recover total amount Rs. 3 billion 460 million (principal and interest) from the borrowing mill. However, the amount has not been recovered yet.

101. **Outstanding Rent -** There is a total outstanding of Rs. 176 million including rent Rs. 80 million and interest Rs. 96 million to be collected from the tenant of the Karmach Sanchaya Kosh building at Sundhara. The tenant is collecting rent by constructing additional sheds towards Sundhara in contrary to agreement. However, outstanding rent has not been collected from the tenant.

102. **Late Fees -** The rule 28(3) of the Airport Service Fee Regulations, 2067 (2010) requires collection of late fees. However, Civil Aviation Authority of Nepal (CAAN) has not collected late fees of Rs. 76 million from 32 agencies who paid their fees late.

103. **Rent of Shutters-** Nine different hospitals have not collected shutter rent amounting Rs. 22 million that include Hospital Development Committee, Bharatpur Rs. 13 million, Kanti Bal Aaspatal Rs. 3.6 million, Paschimanchal Regional Hospital Rs. 2 million, Bheri Zonal Hospital Rs. 1.5 million.

▪ Internal Control

104. **Overall Situation -** There is a general trend of not complying with the provisions stated in rule (95) 1 of the Financial Procedures Regulations, 2064 (2007) as most of the concerned ministry/department have not prepared and implemented internal control system, concerned ministries/departments have not undertaken inspection and monitoring, salary reports have not been passed and the procurement plan was not prepared. The internal audit conducted by the District Treasurer Comptroller Office has not been effective. The problems such as lack of adequate manpower for internal audit, lack of ample opportunity to be trained for the persons involved in audit and non-adoption of the procedures mentioned in Internal Audit Directive, 2068(2011) continue to exist.

105. **Tax Audit -** The number of tax payers who has received permanent account number (PAN) from the Internal Revenue Department are 626,000. Out of this number, only 264,207 (42.22 %) taxpayers have submitted return details. This year, 2977 tax payers have been selected by IRD for tax audit. The audited number is only 0.48 percent of total tax payers with PAN and 1.14 percent of tax payers submitting income returns. Likewise, tax audit was conducted of only 3,672 (50.38 percent) tax payers out of 7,288 (4,311 carried forward from last year and 2,977 selected this year). This problem may appear in controlling revenue leakage because internal control becomes weak in the absence of tax audit.

106. **Deposits -** Rule 64, of the Financial Procedures Regulation, 2064 (2007) specifies that deposit should be settled by after achieving the purpose of holding deposit. It was noted that various Internal Revenue Offices transferred Rs. 1 billion 58 million to revenue account which was to be hold until the courts gives verdict on the appeal of tax payers

against tax assessment. But, such transfer was made before the court gave its verdict on appeal. Deposit of such money in revenue account was shown as the respective year of transaction took place and personal account number of taxpayer was stated in the voucher. It has created the risk of adjusting the amount of income tax to be collected in the year of transaction because the revenue accounting software shows the amount collected on the year of transaction took place.

Inability to collect the amount to be received, to establish an appropriate internal control system to minimize leakage in revenue, to make internal audit system effective and continuous increase in the leakage of electricity amount of outstanding tariff are the weaknesses of internal control system.

In case of VAT after depositing the amount, current system do not calculate interest and penalty on regular tax to be paid because computer system enters permanent account number of tax payer and tax amount while settling deposit and transferring same to revenue account. Therefore, it is necessary to make policy arrangement to hold the amount or make it nil by taking immediate action on amount transferred to revenue account.

107. **Outstanding Electricity Tariff -** The outstanding amount of electricity tariff of the Nepal Electricity Authority (NEA) has increased by 18.14 % compared to the last year and reached Rs. 7 billion 900 million. However, net outstanding amount has been reduced by Rs. 221 million in Office-wise account. There is no basis to show reduced amount. The statement of dues to be collected from black listed clients was not made available and amount outstanding related to street light Rs 1 billion 542 million has not been collected.

108. **Leakage of Electricity -** It was observed that the Nepal Electricity Authority (NEA) loses a total of 1066 gigawatt hour (GWH) out of total 4,260 GWH (NEA's own production 2292 (GWH) and purchase 1,968 GWH and adjusted after sales. On the basis of the average price of electricity purchased from independent energy producers and imported electricity the total cost of electricity leakage accounts Rs. 7 billion 350 million. Such loss should be controlled by calculating leakage caused by technical and non-technical reasons.

109. **Omission in Billing -** Civil Aviation Authority of Nepal (CAAN) has omitted to bill Rs. 198 million which includes Rs. 19 million to one Airlines company related to different headings, Rs. 150 million to three companies for the use of yard to keep equipments and Rs. 29 million to two companies related to rent.

4. Suggestions for Future Reforms

Without limiting the audit function only to pointing the irregularities, the Auditor General since last year has adopted a policy of suggesting some practical and realistic reforms. Such suggested reforms are yet to be realized for effective implementation. In order to contribute to overall financial management reforms, following recommendations are provided:

1. **Implementation and monitoring of the decisions of the Public Accounts Committee (PAC)** - As most of the decisions of the PAC made on the basis of discussion on the issues highlighted in the Auditor General's Annual Reports are found not to be effectively implemented. Hence, such decisions should be effectively implemented and monitored.

2. **Implementation of Audit Report Recommendations -** As responsible officials have not paid attention in clearing irregularities highlighted by the Auditor General, audit irregularities have been rising every year and expected progress has not been achieved in maintaining financial governance. There is a need to clear irregularities within one year and if this cannot be achieved, the records of irregularities should be maintained in the Kendriya Tahasil Karyalaya (Central Recovery Office) and cleared on time to make the process of clearing audit irregularities effective.

   Responsible officials should pay equal attention to clear irregularities that are recorded and of policy nature which are not recorded. However, current situation reveals that attention has been given to clear quantified irregularities and a very limited attention is given to irregularities that are not quantified. There is a need to establish a system of integrating the efficiency of concerned employees in clearing irregularities with their career development.

3. **Independence of the Auditor General (AG) -** It is necessary to ensure the full independence of the Auditor General by making him independent from executive entities. Existing legal provisions should be revised and improved to provide full independence to the Auditor General to allow him to acquire required budget and manpower including human resource management in view of increasing auditing workload, technical complexities, and the need to address issues arising from the introduction of new technology.

4. **Legal Provisions -** Existing legal provisions should be improved by including the authority of the Auditor General to submit audit report as deemed necessary and keeping the records of officials who deny to furnish required evidence and information to make the role of the AG more effective.

5. **Improvements in the Accounting System -** There is a need to implement cash based Nepal Public Sector Accounting Standards (NPSAS) approved by the GON, include all transactions into the single Treasury System of Accounts (TSA), revise a number of

accounting forms approved earlier by government which are not in use at present and developing account system that is based on information technology to make the system simple, fast and reliable.

6. **Internal Control -** Internal controls have not been effective in most line ministries utilizing public resources to deliver public services due to following: internal control procedures and directives have not been prepared; lack of regular monitoring system; and ineffective internal auditing system.. It is necessary to make internal control system effective by developing organizational structure, by making legal provisions, by augmenting the capacity and institutionalizing good internal control practices.

7. **Audit of the Corporate bodies -** Current situation revealed that financial statements are not prepared on time, final audit of a number of corporate bodies has not been conducted**,** some bodies have not taken actions to implement the audit observations and concerned supervisory entities have not monitored such status. Most of the corporate bodies majority owned by government has not taken advice of the Auditor General while appointing auditor as required by the law. Regular auditing and monitoring is to be done to make their financial administration clear, trustworthy and responsible as required by law.

8. **Budget -** The state of budgetary discipline has been weak because of the system of making budget without the study of local demand and commitment of resources, not sending budgetary authorization in a timely manner, amending programs multiple times and making budget transfer or virement. It is necessary to determine priority and select project by conducting feasibility study and the analysis of cost benefit, formulate budget on the basis of local needs and issue authorizations to concerned officials in time. As the progress of the projects of national pride implemented on prioritized basis has been minimum and some of those project are not yet implemented, it is necessary to make adequate budget provision and implement them.

9. **Mobilization of Revenue** - Revenue collection has not been increased as expected for reasons including revenue projection not based on reality, not been able to expand tax base, the share of direct tax not been increased as expected and inability to control revenue leakage. Revenue arrears amount has been increasing every years because entities and officials responsible have not taken action to collect revenue in time. It is necessary to modernize tax administration, take timely action to collect outstanding revenue, make tax examination and monitoring effective and expand tax base by education to tax payers.

10. **Foreign Aid** - Foreign aid has not been mobilized effectively and all aid amounts are not reflected in budget. There has been no progress on the recommendation given earlier by the Auditor General that relates to including all foreign aid received also in the form of technical and commodity aid in budget and audit arrangement to be carried out by the

Auditor General. The provision of including all kinds of aid in the budget and their audit conducted by the Auditor General should be strictly reinforced.

11. **Public Expenditure Management -** Public expenditure management is not efficient due to following factors: procurement plans are not prepared by public entities, contracts not executed on time, delays in decision making, procurement carried out without competition, and ineffective and weak monitoring. Public expenditures have not been effective and optimal due to practice of procuring with limited competition and increasing trend of spending towards the end of fiscal year (bunching of expenditures). As per the legal provision, it is necessary to execute contracts on time as per the procurement plan, simplify decision making process, procure based on competition and institute regular monitoring in order to ensure the quality of works.

12. **Local Bodies** – The fiscal responsibilities and accountability of Local Bodies have not been effective due to absence of elected representatives in local bodies for a long time. The audits of Municipality and Village Development Committees are not in the purview of the Auditor General. As significant amount of resources from government treasury have been allocated to the Local Bodies in their capacity as local government, proper arrangements should be made to ensure fiscal transparency, compliance with law, and monitoring of audits of local bodies.