Progress Report on Financial Management 2011/12

Report Prepared for Joint Annual Review (JAR)
January 2013

Government of Nepal (GoN)
Ministry of Health and Population (MoHP)
Ramshah Path, Kathmandu, Nepal

EXECUTIVE SUMMARY

The efforts made during the first two years of NHSP-2 have contributed to financial management, specifically in improving the internal control system, introducing a financial management improvement plan (FMIP), developing an information system and reducing the proportion of audit queries against audited expenditures. This report intends to briefly describe the MoHP's progress in financial management during fiscal year (FY) 2011/12.

MoHP has endorsed a FMIP which has a list of specific indicators to improve the performance of financial management. In order to review the progress of the FMIP and provide technical support in public financial management, MoHP has formed a Public Financial Management (PFM) technical committee. The chief of the Policy Planning and International Cooperation Division (PPICD) chairs the committee, and officials from External Development Partners (EDPs) participate as members. More importantly, MoHP has formed an Audit Committee under the leadership of the secretary. MoHP has approved the Transactional Accounting and Budget Control System (TABUCS) implementation plan and selected 11 cost centres to pilot the TABUCS.

MoHP has also included a separate chapter concerning financial management in the first Service Tracking Survey (STS). The report has highlighted issues related to fund flow, reporting, local revenue generation and audit practices. Significant improvement has been made in reducing audit queries against audited expenditures, from 9.5% in 2007/08 to 5.8% in 2010/11. The Office of the Auditor General (OAG) highlighted several issues including recording, internal control and expenditure practices. One of the issues that continuously appears in the OAG's report is that the direct budget execution and audit practices of some EDPs are an important problem to be addressed. MoHP is committed to develop guidelines for an internal financial control system and performance based grants.

TABLE OF CONTENTS

ACRONYMS

DTCO	District Treasury Comptroller's Office
eAWPB	electronic Annual Work Plan and Budget
EDPs	External Development Partners
FCGO	Financial Comptroller General's Office
FMIP	Financial Management Improvement Plan
FMRs	Financial Monitoring Reports
FY	Fiscal Year
GAAP	Governance and Accountability Action Plan
GoN	Government of Nepal
MoHP	Ministry of Health and Population
OAG	Office of Auditor General
PFM	Public Financial Management
PHCC	Primary Health Care Centre
PPICD	Policy Planning and International Cooperation Division
SHP	Sub Health Post
STS	Service Tracking Survey
SU	Spending Unit
TABUCS	Transaction Accounting and Budget Control System
TSA	Treasury Single Account
VDC	Village Development Committee

1 INTRODUCTION

1.1 Background

Financial management refers to the capacity to plan in accordance with national acts, regulations, policies, guidelines and fiscal frameworks, to prepare budgets and ensure their timely release, to ensure transparent and timely accounting for spending, and to provide follow up financial auditing of expenditures, including assessment of value for money. During NHSP-1 and the initial two years of NHSP-2, activities were implemented to strengthen the financial management system and thereby improve performance in financial management. These efforts have contributed to the timely authorisation of budgets, improved financial reporting and improvements in the decision making process through audit clearance and public financial management (PFM) committees. In particular, efforts made during the initial stage of NHSP-2 have already resulted in reducing audit queries at all levels and facilitating prompt responses to any such queries that do arise.

1.2 Objectives

This report intends to briefly describe the progress made in the financial management during FY 2011/12. The report specifically highlights progress made in systems development, committee formation, expenditure patterns, auditing and addressing related queries, and includes the challenges faced and the way forward.

2 PROGRESS MADE

MoHP has made impressive progress in developing a financial management improvement plan and a financial management system with a Web-based electronic Annual Work Plan and Budget (eAWPB), and in completing the software development for the Transaction Accounting and Budget Control System (TABUCS). This has positively influenced the fund absorption capacity, despite a delay in preparing and approving the budget in FY 2011/12.

2.1 Financial Management Improvement Plan FY 2012/13 to FY 2015/16

There is wide agreement that effective institutions and financial management systems have a critical role to play in supporting implementation of national development and poverty reduction policies, and in particular help achieve health related targets. In order to strengthen the current good practices and implement new initiatives, this Financial Management Improvement Plan (FMIP) has been prepared and endorsed by the Ministry of Health and Population (MoHP). The FMIP, which is an addendum to the plan contained in the Governance and Accountability Action Plan (GAAP), intends to strengthen the MoHP's current practices on financial planning, accounting procedures, its internal control system, financial reporting, monitoring, auditing and transparency measures. The plan also intends to enhance the capacity of the human resources working in the planning and financial management sectors. The objectives and their indicators are included in the following table. The FMIP draws on audit observations and also on the categories of the internationally-recognised standardised approach to public financial management known as PEFA – the Public Expenditure and Financial Accountability framework (www.pefa.org). PEFA implementation unit has been established under the leadership of chief of PPICD which has organised a one day orientation to the staff members from all departmens, centers and divisions. The overall thrust of implementing the FMIP is to reduce fiduciary risk and to improve overall financial accountability in the health sector. Following are the key results indicators:

Figure 1: Key indicators of FMIP

Source: FMIP

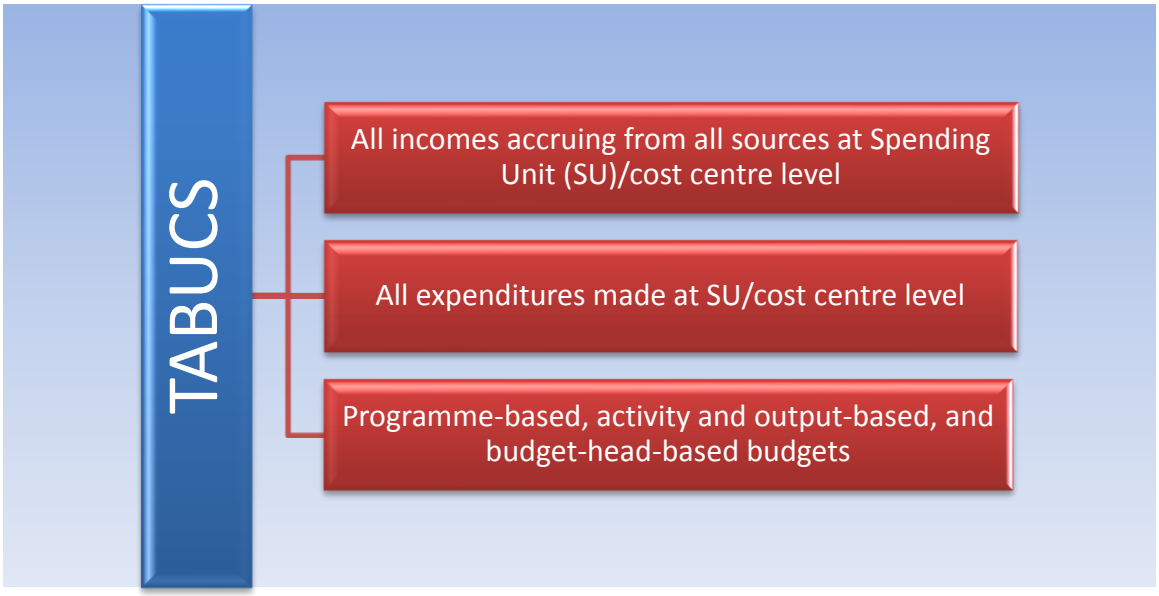
Detailed information is available in the report on the FMIP (www.nhssp.org.np).

2.2 Transaction Accounting and Budget Control System (TABUCS)

MoHP has taken the lead role in introducing the TABUCS while NHSSP provides technical assistance and DFID provides the financial support. The TABUCS implementation plan, the selection of 11 pilot spending units, and draft software have been prepared. Currently, MoHP plans to begin the pilots from the first week of January 2013.

TABUCS is a simple accounting system which allows for the capture of basic accounting transactions at the source level, and enforces budgetary control procedures so that no expenditure can take place without an approved budget. The basic functions of the TABUCS could include the following: processing of expenditures and payments; automatic posting of payments to ledger accounts and summary accounts; processing of cash and bank receipts and revenues; automatic posting of receipts to ledger accounts and summary accounts; automatic posting in cash and bank books; and the generation of all ledgers and accounting and Management Information System reports, including Financial Monitoring Reports (FMRs). It is important to keep in mind that the TABUCS proposed here will only serve as a small but key component of a full-fledged Financial Management Information System required by the MoHP for comprehensive financial management at the ministry level. The following areas of budget and accounting data are considered to be within the current scope of the TABUCS:

Figure 2: Scope of TABUCS



Source: TABUCS, System Specification

By way of corollary, anything which is not covered within the above mentioned three heads is not covered under the current scope of TABUCS. Eventually, TABUCS is be operationalised at 274 SUs, including the 75 district health offices. However, for the purposes of the pilot, only nine locations/field offices have been selected by MoHP. Once the TABUCS solution is successfully operationalised, it will be rolled out to all other locations.

2.3 Financial Monitoring Report (FMR) Preparation Manual

As the basis for disbursement of further funds by pool partners, the FMR must be submitted to the development partners within 45 days of the end of the relevant trimester. To address the difficulties encountered with timely submission of this report, MoHP has developed a draft FMR preparation manual with technical support from NHSSP. This manual will be effective in improving both the quality and the timeliness of the FMR, compared with the first two years of NHSP-2. Importantly, Government of Nepal's (GoN's) decision to implement the 12-month financial reporting cycle in all 75 districts (previously the 14 remote districts had an 18-month financial reporting cycle) will contribute to timely production of the FMR. MoHP has sent a request letter to the Financial Comptroller General's Office (FCGO) for web connectivity through which financial data from the finance section of MoHP can be accessed. Since a major cause of delay is the time consuming process of collecting and compiling reports from the FCGO, it is expected that the introduction of TABUCS will ensure the timely submission of the FMR.

2.4 Web-Based Electronic Annual Work Plan and Budget (eAWPB) Upgraded

The current eAWPB is web-based, which allows planners working in different divisions and centres to upload their plans directly from their offices for consolidation by MoHP. This eAWPB provides a procurement plan which MoHP can share with EDPs. The new development includes a provision for district planning, enabling centres and divisions to prepare district wise plans. There is also a provision for disaggregation of information by facility level, region, gender, programme area and district. More importantly, the revised version of the eAWPB also provides for expenditures which are in line with the NHSP-2 result framework.

2.5 Service Tracking Survey Conducted

An important part of the monitoring plan for NHSP-2 is to undertake regular Service Tracking Surveys (STS) that also provide information on financial management. STS was conducted in a total of 169 health facilities in 13 districts. Following are the key findings related to financial management.

The MoHP is the main financier for all levels of health facilities. For Sub Health Posts (SHPs), local government, meaning village development committees (VDCs), are the second largest source of income. The study's SHPs were found to have the most diverse income sources, with international donor agencies providing almost a fifth of their income. Salaries were the main expenditure item for all the facilities, representing between a third and a half of facilities' budgets. This is a common situation in the health sector budgets of many countries.

Out of the 169 surveyed health facilities, the vast majority (94%) had a bank account. No marked difference was seen between facility types. However, further analysis by ecological zone showed differences between regions, with only 85% of facilities in the mountain districts having a bank account.

All the hospitals reported having developed a financial report for the previous fiscal year. This practice was less widespread in lower level facilities, with only 36% of Primary Health Care Centres (PHCCs), 27% of health posts and 10% of SHPs having done so. It is important to note that PHCCs, health posts and SHPs are not spending units (or cost centres) and thus are not required to produce financial reports. They nevertheless have to submit receipts to clear advances obtained from their district health offices. Some differences appeared between ecological regions, with 32% of facilities from the

mountains, 31% from the hills and 21% from the Tarai having prepared a financial report. Most facilities reported that they had not conducted an internal financial audit or a final audit in the last fiscal year. While 75% of the hospitals had prepared both, only between 9% and 40% of the other facilities had prepared one and/or the other. For detailed information, visit www.nhssp.org.np.

2.6 Treasury Single Account (TSA)

The Treasury Single Account (TSA) was recommended by the International Monetary Fund in its Dec 2009 study report, and GoN took the decision to implement the TSA in January 2010. In this system, governments' transactions are carried out through a single or limited set of bank accounts. The unified structure of the bank accounts gives a consolidated view of the government's cash resources at any given time, and the government monitors all its receipts and payments for cash management. Under the leadership of the FCGO, TSA is being implemented at 60 District Treasury Comptroller's Offices (DTCO). Following are the major attributes of TSA:

- Treasury Accounts reside only at the Central Bank;
- Zero-balance single accounts are held at commercial banks for payments in place of multiple accounts;
- There is a single cheque issuing agency in place of multiple cheque issuing agencies;
- Zero-balance single accounts for revenue collection are held at commercial banks;
- End-of-day Settlement: all the balances of government accounts with commercial banks are brought to a single Treasury Account in Nepal Rastra Bank at the end of the day.

The major contributions of TSA in the health sector have yet to be analysed systematically. However, TSA has contributed to addressing the issues related to idle cash balances in accounts, delays in financial reporting, a lack of cash planning and forecasting, and a lack of accurate information about treasury balances.

2.7 Formation of the Audit Committee

In order to improve financial discipline, MoHP formed an Audit Committee in April 2012. The secretary of MoHP chairs the committee. The committee has prepared a ToR that includes the provision of strengthening the internal control system, ensuring financial discipline, organising regular meetings and responding to audit queries. The composition of the committee is as follows:

Table 1: Composition of the Audit Committee

SN	Name	Position in Committee	Position/Office
1.	Dr. Praveen Mishra	Chairperson	Secretary/MoHP
2.	Mr. Dhurba Dahal	Co-chairperson	Chief/HR&FMD-MoHP
3.	Dr. Mingmar Gyaljen Sherpa	Member	DG/DoHS
4.	Mr. Gyanendra Paudel	Member	Chief/DoHS finance section
5.	Dr. Babu Ram Marasini	Member	Chief/HeSRU
6.	Mr. Shiva Prasad Simkhada	Member Secretary	Chief finance section/MoHP

Source: MoHP 2012. Decision of the Audit Committee

2.8 Formation of the Public Financial Management (PFM) Committee

MoHP has formed a public financial management (PFM) committee with a clear mandate to improve the performance of MoHP's financial management. The chief of PPICD chairs the committee and officials from EDPs participate as members. The committee has taken a lead role in introducing and approving the FMIP. The meeting of the PFM committee happens as needed. The composition of the committee is as follows:

Table 2: Composition of the PFM Committee

SN	Name	Position in Committee	Position/Office
1.	Dr. Padam Bahadur Chand	Chairperson	Chief-PPICD/MoHP
2.	Mr. Dhurba Dahal	Member	Chief/HR&FMD-MoHP
3.	Dr. Naresh Pratap K.C.	Member	Director/LMD-DoHS
4.	Mr. Kabiraj Khanal	Member	Undersecretary/PPICD-MoHP
5.	Mr. Shiva Prasad Simkhada	Member	Chief/MoHP finance section
6.	Mr. Gyanendra Paudel	Member	Chief/DoHS finance section
7.	Mr. Matt Gordon	Member	DFID
8.	Mr. Bigyan Pradhan	Member	WB
9.	Ms. Shanda Steimer	Member	USAID
10.	Mr. Shanker Pandey	Member	KfW
11.	Ms. Latika Maskey Pradhan	Member	AusAID
12.	Dr. Suresh Tiwari	Member	NHSSP

Source: MoHP 2012

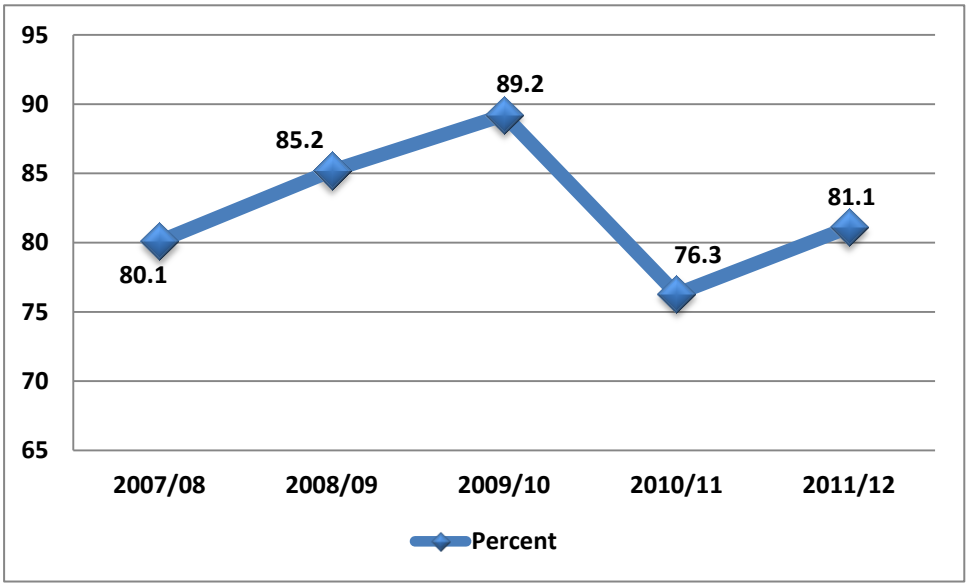
2.9 Procurement Training Conducted

The PPICD and the Financial Management Section have provided support for preparing an integrated procurement plan for goods. Some of the programmes developed annual procurement plans at the time the AWPB was being approved. PPICD has provided training to planners from all divisions and centres to ensure that procurement plans are included in the eAWPB. Additionally, as a routine activity, procurement training (for goods and services) has been jointly provided by the Logistics and Management Division and the Finance Section of DoHS to appropriate personnel from all 75 districts.

2.10 Absorption of the MoHP Budget

Figure 3 shows the total budget absorption capacity of MoHP over the past five-year period.

Figure 3: Budget absorption capacity



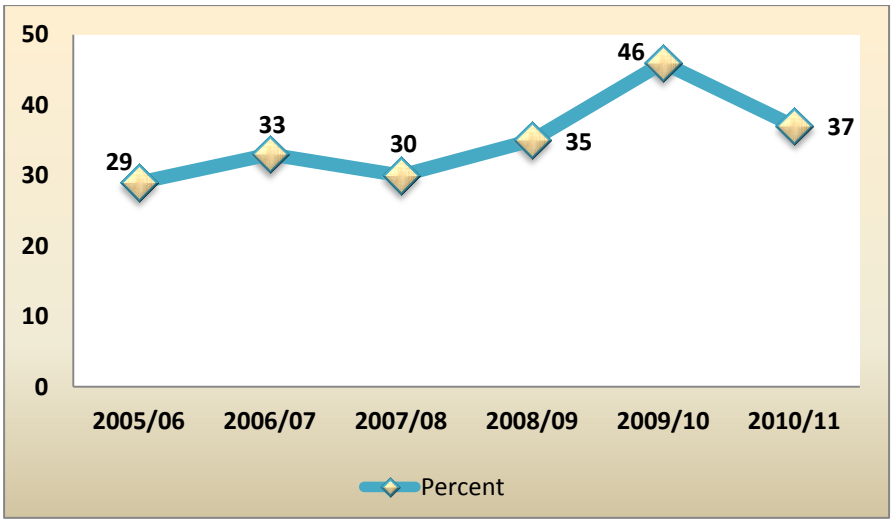
Source: MoHP, 2012

The overall budget absorption capacity of MoHP increased by 5%. The delayed budget approval has caused the low absorption rate in both FY 2010/11 and FY 2011/12.

2.11 Clearance of Queries

Improvement has been made both in reducing the number of audit queries and in the process of clearing those queries. However, a high level of commitment is required to prevent the irregularities and ensure timely clearance. The broad nature of audit queries can be classified as non-compliance with legal provisions, a weak internal financial control system and weak budget implementation. The cumulative amount of total irregularity reported by OAG in the 48th report is NPR 2.42 billion, and 37% of the queries have been cleared by MoHP

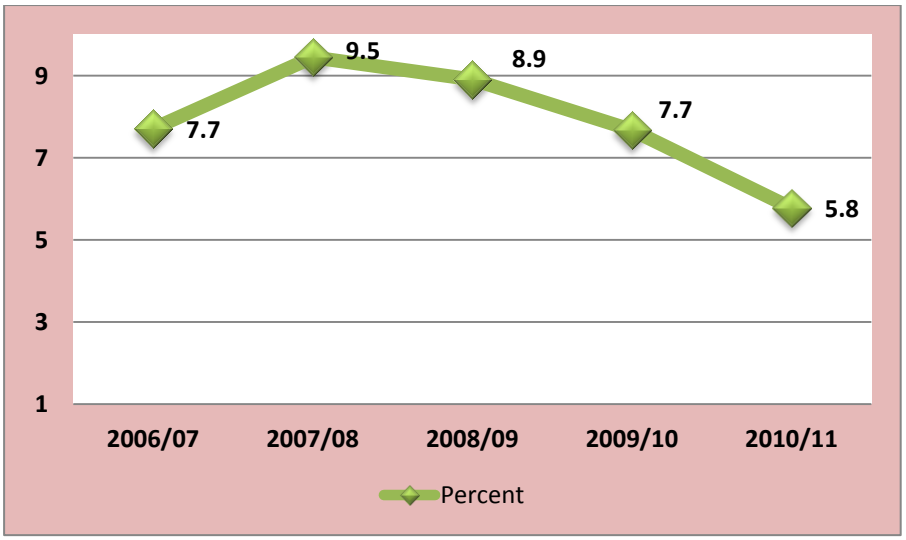
Figure 4: Trends in Clearance of Audit Queries



Source: MoHP 2012

It is important to note that the proportion of audit clearance has decreased in the year 2010/11. Considering the importance of improvement, MoHP has formed the Audit Committee under the leadership of the secretary. However, it should also be noted that the proportion of audit queries against the total audited expenditure has decreased from 9.5% in FY 2007/08 to 5.8% in FY 2010/11.

Figure 5: Proportion of Irregularities against the Audited Expenditures



Source: MoHP 2012

The decreasing trend of irregularities and increasing clearance of irregularities demonstrates that MoHP has made good progress in financial management.

2.12 Audit Observations and Responses

OAG conducts the compulsory final audit of all the cost centres under the MoHP. It also conducts performance audits randomly. This makes it quite challenging for MoHP to discuss all the queries and

responses in this brief report. It is important to note that MoHP has given a high priority to responding to the audit queries. Table 3 shows the major OAG audit queries.

Table 3: Audit Observations and Responses

S.N.	Audit Observations	Actions taken
1.	**Follow-Up on Procurement Planning:** The Public Procurement Act has prescribed preparing an annual procurement plan for purchasing goods and services exceeding NPR 1 million. Fifty-one DHOs and 16 hospitals under MoHP made procurements without a plan. DoHS, including 48 DHOs and 21 hospitals, procured medicine and equipment worth NPR 22.070 million without competitive bidding. We suggested making clarifications last year but no improvement has yet been made.	MoHP has instructed all cost centres to follow the Procurement Act. MoHP is currently working to improve the consolidated procurement planning process.
2	**Direct Purchase:** Public procurement regulation 2064, rule 31 says to follow competitive bidding procedures when procuring goods and services over NPR 300 thousand. However many agencies are not following this provision.	When special reasons are found, direct procurement is allowed by departmental decision; otherwise strict action will be taken after reviewing the justification from the concerned offices.
3	**Quality Test:** A medicine supplier supplied the last lot of medicine worth NPR 25.500 million within the contract period. But DoHS Epidemiology and Diseases Control Division stored the medicine in the Pathlaiya medical store after 107 days. A quality test of those medicines has also not been done yet. Similarly, 14 DHOs procured medicines worth NPR 105.979 million without a quality test.	The reported quality control case has been regularised and presented to OAG with justification.
4	**IVF System Purchase:** On 13th July 2010, Paropakar Maternity and Gynaecology Hospital, Thapathali contracted a company to procure an IVF system to be supplied by 10th October 2010 for a cost of NPR 18 million. The machine has still not been supplied as per the contract agreement. An advance amounting to NPR 11.618 million has been provided to the supplier.	The delay in supply has been noticed and letters issued to obtain delivery.
5	**Internal Control Directives**: Financial Procedure Regulation-2007 directed the preparation and implementation of internal control directives. MoHP has not yet developed a system for internal control.	Preparation of internal control directives started from fiscal year 2011/12 and the first draft has been presented. The draft will be finalised and circulated within this fiscal year.
6	**Foreign Assistance:** It is observed that Technical Assistance of NPR 8532.769 million was to be received from 13 donors to run 12 programmes. The financial statements relating to such assistance have not been submitted in the audit. Likewise, Child Health Division has not submitted the accounts of NPR 59.729 million in foreign assistance	The financial transactions for Technical Assistance are maintained by the donor agencies and such transactions are audited by an auditor they appoint. The audited figures are included in the national expenditure.

S.N.	Audit Observations	Actions taken
	provided by four internal donors for audit.	
7	**Monitoring:** MoHP has provided conditional grants of NPR 14.760 million to seven health institutions run by the private sector. MoHP has not monitored the use of these grants. These institutions are not under the purview of the OAG's audit.	MoHP is currently preparing the guidelines for performance based grants for hospitals. We will complete the guidelines and implement them by this fiscal year.
8	**Labelling:** Health Service Procedure-2008 has directed labelling "Free Distribution from Nepal Government" on every unit of medicine. In the course of the audit, 10 medicines in 36 DHOs and 11 Hospitals were observed on a sample basis and it was found that only 57% and 78% of the medicine respectively was labelled as prescribed.	Some medicines are seen with non-appropriate labelling due to procurement at the district level. However precautions are being taken not to repeat such mistakes.
9	**Medicine Stock**: In the course of the audit, the stock books of five medicines in six DHOs were verified on a sample basis. A large amount of medicines were found to be over stocked and near to their expiry date.	MoHP has instructed all regional drug stores and DHOs to work on the supply chain and destroy the expired drugs.
10	**Aama programme**: Janakpur Zonal Hospital spent NPR 15.848 million on payments for medical equipment, medicine, and incentive distributions to staff instead of using them for maternity purposes. The hospital is not providing clarification in the audit for doing so	A strict instruction will be provided to the Janakpur hospital and other Aama programme implementing facilities.
11	**Follow Up:** We followed up on the previous year's audit observations and the status relating to NHSP-1 but the status report was not produced for us during this audit period.	Most of the observations were cleared.

3 MAJOR CHALLENGES

The Ministry of Health and Population has made good improvement in financial management. However, a number of challenges still need to be resolved:

3.1 Policy Level Challenges

Key policy level issues to be addressed are effective implementation of the recently developed financial management improvement plan, proper implementation of the GAAP, the practice of direct budget execution by some EDPs, weak forecasting of external assistance and separate reports and audits from EDPs.

3.2 Local Revenues not Recorded in MoHP's Expenditure

Currently, there is no national mechanism to capture the local revenues and expenditures that are occurring in the health facilities. This indicates that MoHP has no institutional mechanism to report the total health expenditure under its umbrella.

3.3 Challenge related to Budget Preparation

A fundamental issue is that the budget preparation process is not sufficiently coordinated with the planning processes. The involvement of the Finance Section during the budget preparation process and the progress monitoring process needs to be formally introduced in the MoHP.

3.4 Challenge Related to Budget Execution

Delayed approval of the budget was the major challenge for the proper execution of the health budget. This delay also directly contributed to some cost centres violating the financial rules and regulations, specifically concerning procurement. There are about 1,700 activities defined at DoHS level and about 300 for each district. The preparation and consolidation of performance information on all these activities requires considerable time and effort. The issue is exacerbated by lack of a technology based system for recording and monitoring these activities at the level of the spending units. Additionally, under decentralised mechanisms the funds are routed to the spending units through the DDC, creating another layer in the fund flow.

3.5 Linking Monitoring Data with Programme Planning

During the budget analysis process there was substantial discussion about linking the monitoring data from the Health Management Information System with the AWPB. MoHP officials, NHSSP advisers and consultants have agreed to develop a framework for achieving this. Policy level guidance is required to formalise this task.

3.6 Challenge Related to Accounting

The accounts of MoHP and its cost centres are maintained by FCGO/DTCO. The monthly process of reconciliation of accounts between FCGO/DTCO's reports and the records maintained by the cost centres is generally late and some key expenditure information, especially the expenditures by programme activities, is not captured adequately.

3.7 Auditing

The Ministry of Finance has highlighted weaknesses in internal control mechanisms and requested the FCGO to take steps to improve the situation. The devolution process does not require the DTCO to conduct internal audits for devolved districts, recommending instead internal audits by independent auditors, copied to the DTCO. The DoHS does not have sufficient staff capacity to follow up on a large number of internal audits and external audits on a timely basis.

3.8 Recording, Reporting and Monitoring

All cost centres do not send timely budgets vs. actual expenditure to MoHP/DoHS. Also MoHP does not have any technology based solution to compile/consolidate budget vs. actual expenditure reports. FCGO provides budget vs. actual reports on a periodic basis to MoHP. However, these reports are based on particular account heads and are not broken down by programmes.

4 THE WAY FORWARD

1. Develop a budget preparation manual clearly defining the role of the institutions and individuals.
2. Prepare a national framework to report the local revenues and their expenditure in the health facilities.
3. Develop and implement the guidelines on an internal control system and procurement.
4. Scale up TABUCS at the national level.
5. Upgrade the existing eAWPB and provide for analysing the procurement plan.
6. Develop human resource capacity in the areas of financial management, strategic planning and the use of technology based solutions. This will require investment in financial and human resources to enhance capacity.
7. Organise interaction programmes with OAG and FCGO.
8. Strengthen the existing audit committee through regular meetings. Discussions and decisions on the audit related queries must be timely.

REFERENCES

Adhikari, Rajan; Adhikari, Pankaj; Tiwari, Suresh; Thapa, Mohan; Paudel, Lila Raj; Pandit, Shiva; Lamichane, Prabhat and Lievens, Tomas (2011). Electronic annual work Plan and budget (eAWPB) version 3. MoHP, Kathmandu, Nepal.

MoHP (2010). Nepal Health Sector Programme- II (2010-2015). Kathmandu, Nepal.

OAG (2011). Audit report submitted to President of Federal Republic of Nepal, Kathmandu, Nepal.

Saxena, S; Thapa, M; Adhikari, R and Tiwari, S. (2011). Transaction Accounting and Budget Control System (TABUCS). MoHP, NHSSP Kathmandu, Nepal.

Tiwari, S; Lekhak, SC; Baral, P; Thapa, MP; Adhikari, R and Paudel LR (2011). Budget Analysis of MoHP 2011/12. MoHP, Kathmandu, Nepal.