

**Report No. 27551-PAK**

# Islamic Republic of Pakistan Country Financial Accountability Assessment

**December 30, 2003**

Financial Management Unit  
South Asia Region



**Document of the World Bank**

---

## GOVERNMENT FISCAL YEAR

July 1 - June 30

### CURRENCY EQUIVALENTS

Currency Unit = Pakistan Rupees (PKR)

US\$1 = PKR 58.1 (September 15, 2003 Floating Inter Bank Rate)

### ACRONYMS AND ABBREVIATIONS

AA	Assignment Account	MIS	Management Information System
AFMF	Accountable Fiscal Management Framework	MoF	Ministry of Finance
AG	Accountant General	MTBF	Medium-Term Budget Framework
AGP	Auditor General of Pakistan	NAM	New Accounting Model
AGPR	Accountant General of Pakistan Revenues	NBP	National Bank of Pakistan
CBR	Central Board of Revenue	NGO	Non-Governmental Organization
CFAA	Country Financial Accountability Assessment	NSFCB	New System of Financial Control and Budgeting
CFO	Chief Financial Officer	NWFP	North West Frontier Province
CGA	Controller General of Accounts	PA&AS	Pakistan Accounts & Accounts Audit Service
DAC	Departmental Accounts Committee	PAC	Public Accounts Committee
DAO	District Accounts Office	PAO	Principal Accounting Officer
DFID	Department for International Development (United Kingdom)	PE	Public Enterprise
DO	Disbursement Officer	PEM	Public Expenditure Management
ERO	Economic Reforms Order	PER	Public Expenditure Review
FA	Financial Advisor	PFAA	Provincial Financial Accounting Assessment
FMC	Fiscal Monitoring Committee	PFC	Provincial Finance Commission
FPSC	Federal Public Service Commission	PFM	Public Financial Management
FY	Fiscal Year or Financial Year	PIFRA	Project to Improve Financial Reporting and Auditing
GDP	Gross Domestic Product	PIPFA	Pakistan Institute of Public Financial Accountants
GFS	Government Finance Statistics	PLA	Personal Ledger Account
GoP	Government of Pakistan	PRSP	Poverty Reduction Strategy Paper
GoS	Government of Sindh	PSDP	Public Sector Development Plan
GST	Goods and Services Tax	PR	Pakistan Rupee
HRM	Human Resource Management	ROSC	Review of Standards and Codes
IAS	International Accounting Standards	SAC	Structural Adjustment Credit
IBRD	International Bank for Reconstruction and Development	SAP	Systems, Applications, and Products
IDA	International Development Agency	SBP	State Bank of Pakistan
IFC	International Finance Corporation	SOE	Statement of Expenditures
IMF	International Monetary Fund	SRO	Statutory Regulatory Orders
INTOSAI	International Organization of Supreme Audit Institutions	TA	Technical Assistance
IPSAS	International Public Sector Accounting Standards	TMA	Tehsil Municipal Administration
ISA	International Standards on Auditing	TO	Treasury Officer
IT	Information Technology	UA	Union Administration
LGO	Local Government Ordinance	WAPDA	Water and Power Development Authority

Regional Vice President:	Praful C. Patel
Operations Director:	John Roome
Country Director:	John W. Wall
Sector Manager:	Ian Mckintosh
Task Team Leader:	Ismaila B. Ceesay

**PAKIS TAN**  
**COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENT**

**TABLE OF CONTENTS**

<b>Preface.....</b>	<b>ii</b>
<b>Executive Summary.....</b>	<b>1</b>
<b>1. Budget Development And Execution.....</b>	<b>7</b>
Budget Development Benchmarks .....	7
Current Budget Execution and Monitoring Practices.....	10
Budget Implementation.....	11
Budget Management in the Provinces and Districts.....	13
Other Budget Implementation Issues .....	13
Recommendations.....	14
<b>2. Public Sector Accounting, Financial Reporting and Internal Control .....</b>	<b>15</b>
Benchmarks.....	15
Description of Current Accountability Arrangements .....	15
Legislation.....	15
Responsibilities for Accounting, Reporting and Internal Control.....	16
Accounting and Reporting .....	17
Recommendations.....	21
<b>3. External Auditing.....</b>	<b>22</b>
Benchmarks.....	22
Description of Current Accountability Arrangements .....	22
Legislation.....	22
Independence.....	23
Organization .....	23
Audit Methodology and Reporting.....	24
Oversight Arrangements.....	25
Recommendations.....	25
<b>4. Legislative Scrutiny of Public Funds .....</b>	<b>27</b>
Benchmarks.....	27
Description of Recent Past and Current Accountability Arrangements.....	27
Key Issues.....	27
Continuation of Legislative Oversight Process.....	28
Improving transparency of PAC Reports and follow-up .....	29
Increasing Capacity of PACs.....	29
Recommendations.....	30
<b>5. Action Plan Matrix.....</b>	<b>31</b>
<b>Annex 1. Government Reforms.....</b>	<b>34</b>
<b>Annex 2. Public Expenditure Management Under Devolution.....</b>	<b>38</b>
<b>Annex 3. Accounting in Public Enterprises.....</b>	<b>43</b>
<b>Annex 4. Sample Rules for Public Accounts Committees <sup>1</sup>.....</b>	<b>46</b>

## Preface

The objective of the CFAA is to enhance knowledge of public financial management (PFM) and accountability arrangements in Bank's client countries. It supports the exercise of fiduciary responsibilities through assessing the strengths and weaknesses of accountability arrangements in the public sector and identifying risks that these arrangements may pose to the use of public and Bank's funds. It supports the achievement of development objectives by facilitating a common understanding of the country's financial management arrangements on which capacity building programs can be designed and implemented. Separate Assessments were prepared for Sindh Province and North West Frontier Province (NWFP) under the guidance of provincial Steering Committees. The three assessments were carried out in parallel and in consultation to ensure consistency of approach. The Bank team thanks the Governments of Pakistan, Punjab, Balochistan, NWFP, and Sindh, and their officials for their active help and cooperation during the assessments.

The work leading to this report of the CFAA for Pakistan was undertaken in two phases. The first phase, a review of available information, was completed in June 2001 and involved World Bank staff Ahmad Ahsan, John Fitzsimon, Shaheen Malik, Hanid Mukhtar, Vinod Sahgal, Hasan Saqib, and Consultant Ather Zaidi. Peer reviewers for the first phase were William Allan (IMF), Douglas Arnold, and Allister Moon. Paul Bermingham, Evelyn Bosak, John Wall, Roberto Zaghera, William Byrd, John Panzer, Tasnim Beg, and Abid Hasan also provided valuable contributions.

The second phase from January to September 2003 was carried out under a GoP Steering Committee. The Steering Committee was chaired by the Additional Finance Secretary (EF-IFR&P) and included the Finance Secretaries from each Province, and members from the Federal Finance Division, the Pakistan Audit Department, the Office of the Controller General of Accounts, the National Reconstruction Bureau, and the Institute of Chartered Accountants of Pakistan. A workshop with senior GoP officers was held on 9 and 10 May 2003 to provide critical review and input into the draft report and action plan. A second set of workshops was held on 28 and 29 July 2003 to further refine the report.

The team gratefully acknowledges the cooperation extended by Mr. Nawid Ahsan (Secretary, Ministry of Finance), Mr. Muhammad Yunis Khan (Auditor General), Mr. Muhammad Ismail Qureshi (Additional Finance Secretary), Mr. Zafar Hashmi (Deputy Secretary), Mr. Fazul-ur-Rehman (CGA), Mr. Mohsin Khan (Deputy Auditor General), Riaz Ahmed (NRB), Mahmood Akhter (Joint Secretary – Budget), and other government counterparts, donors, and peer reviewers; and the support received from other sector units within the Bank.

The work involved a team comprising World Bank staff, government counterparts, and consultants: Donna Thompson (Task Leader), Ismaila B. Ceesay (Co-Task Leader), Hasan Saqib, Arif Yaqub, Hanid Mukhtar, Manuella Ferro, Jackie Charlton (DFID), and Douglas Porter (Asian Development Bank); consultants Michael Jacobs, Ather Zaidi, Naumann Mahmood, Muhammad Shoaib Ansari, and Imran-ul-Haq. Evelyn Bosak, Ian Mackintosh, Ijaz Nabi, Parvez Hasan, and Abid Hasan also provided advice and assistance. Peer reviewers were William Allan (IMF), John Fitzsimon (CGIAR), David Shand and Parminder Brar (OPCFM), and Riyaz Bokhari (external consultant). Altaf Ahmad and Abdul Qadir assisted with workshops, processing and final formatting of the report.

## Executive Summary

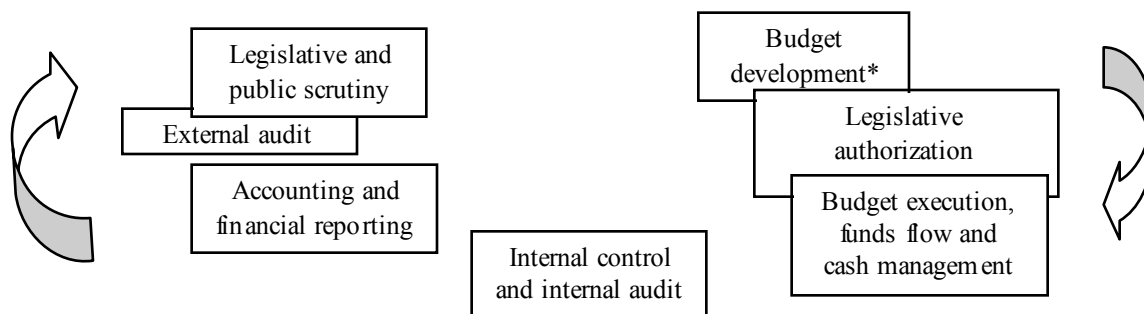
### Pakistan: Country Financial Accountability Assessment (CFAA)

The objective of the CFAA is to enhance knowledge of public financial management (PFM) and accountability arrangements in Bank's client countries. As a diagnostic tool, the CFAA supports the Bank's fiduciary responsibilities by identifying strengths and weaknesses of PFM so that potential risks to Bank funds can be managed. It also supports the Bank's development objectives by facilitating common understanding with the borrower and other development partners to assist in the design of PFM capacity building programs. The CFAA can also be used by the Government of Pakistan (GoP) to manage its internal finances and to strengthen accountability frameworks.

The Pakistan CFAA was completed in two phases to recognize the extensive knowledge already documented by the Government of Pakistan and its development partners on existing financial accountability arrangements. The first phase drew upon analysis already available and the report was provided to the GoP in June 2001. The second phase involved detailed reviews in Pakistan of reforms underway and included a review of progress against the Accountable Fiscal Management Framework (AFMF) agreed between the GoP and the IMF in February 2002.

The CFAA, while essentially a World Bank document, has been prepared, on a Bank/GoP joint effort basis, and with the full participation of all tiers of Government in Pakistan. Indeed, the CFAA process encouraged full country participation consistent with its developmental role, and in consonance with the objective to creating full country ownership of the financial reform measures ascribed in the Report. The CFAA team collaborated extensively with the GoP Steering Committee and the assigned liaison officers, and other donor teams developing the Public Expenditure Review (PER), Devolution Study, and the Project to Improve Financial Reporting and Auditing (PIFRA). Several workshops were held with interested parties to review issues and develop realistic action programs for reforms as delineated in Chapter 5 – Action Matrix.

The CFAA addresses the following public sector activities as they relate to public financial management accountability, and to varying degrees:



\* Budget development is covered extensively in the Bank's Public Expenditure Review (PER, 2003).

### Pakistan's Financial Accountability Arrangements

The GoP has embarked upon an extensive reform program to improve governance, reduce debt, increase public investment, increase revenues, and decrease unwarranted expenditures. The GoP has achieved

good success in all these fronts. The challenge remains, of course, to improve the effectiveness and productivity of public spending not only through a better allocation of resources and a more careful choice of policies and priorities but also through better implementation, more efficient delivery of services, and improved controls over financial flows.

## Key Financial Management Strengths

One major strength is the tremendous potential for existing accountability arrangements in Pakistan to take advantage of the well-developed framework of institutions and regulations. Many improvements have been initiated, including privatizing public enterprises, devolution, rightsizing government, judicial and police reform, and greater transparency in economic decision making. These should contribute to growth prospects and improved service delivery, if sustained and expanded as part of a comprehensive reform agenda. In addition to the initiatives noted above, good progress has been achieved in the realm of public sector accountability as highlighted below:

- A Medium Term Budget Framework (MTBF) has been initiated and a Debt Policy Coordination Office established with consequent opportunities for more rigorous budgeting. A Review of Standards and Codes (ROSC) for Fiscal Transparency was completed by the IMF
- An Interim Poverty Reduction Strategy Paper (PRSP)<sup>1</sup>, which includes institutional mechanisms for better monitoring and evaluation of poverty reduction expenditures and corresponding outcome indicators at the federal, provincial, and district levels, is in place
- Tax policy and tax administration reforms have been initiated which should lead to revenue increases
- Through the ongoing Bank-funded Project to Improve Financial Reporting and Auditing (PIFRA), the government is making significant progress towards establishing an integrated government financial management system; the first computerized District Accounting Office is already at full production stage
- The Controller General of Accounts (CGA) organization is in the process of being strengthened and annual accounts for the Federal Government have been produced within six months of year-end. Under reforms supported by Structural Adjustment Credit (SAC) II, data reliability has improved so that monthly and quarterly Federal reports are posted on the web and budget execution data is sent to ministries by mid-month for reconciliation
- Legislation is in place that requires audited annual accounts for all levels of Government. The Auditor General of Pakistan (AGP) is re-organizing to conduct the required audits using a new methodology, and auditing quality has begun to be improved. Over the past two years, an Annual Audit Program that sets out specific goals and targets has been published. Audit reports for the last three fiscal years have always been delivered to the President (at the Federal level) and Governors (at the Provincial levels) on time – i.e. within the first quarter of the following calendar year. This is indeed an achievement compared to the delays in prior years and the general lapsed time elsewhere in the region

---

<sup>1</sup> Final PRSP is under preparation and is expected to be available by end-December 2003.

- The *ad hoc* Public Accounts Committees (PACs) have completed reviews of audit reports for one or more years. The newly constituted PACs are gearing themselves to dealing with the back-logs of reports in a timely and organized fashion.

Annex 1 lists the main elements of the reforms at Federal level and in the two Provinces for which Provincial Financial Accountability Assessments have been prepared—Sindh and North West Frontier Provinces. The Provincial reform programs in Sindh and NWFP, which are being supported by the World Bank Structural Adjustment Credits, are multi-sectoral and include reform elements for fiscal restructuring, financial management, procurement, the civil service improved PAC and audit response processes.

## Key Financial Management Risks

The various reforms discussed above provide the potential to reduce the risk in Pakistan, of accounting weaknesses and other gaps in the accountability chain. Arising mainly from low institutional and staff capacity and uneven implementation of the reforms measures, there is the urgent need to further strengthen financial reporting, institute adequate controls at all levels of government, especially at the provincial level and below, and maintain effective tracking of social spending. Priority PFM areas requiring effective monitoring and control are as follows:

- *Budget development* is undergoing major reforms with IMF and Bank strengthening programs but issues remain in expenditure prioritization and structures and in operational efficiency. *Budget execution* needs to be strengthened with releases that are timely and allocated as planned. As a principle, unpredictable budget execution severely limits financial reporting and accountability frameworks
- *Accounting, financial reporting, and internal controls* are generally inadequate due to inaccurate and incomplete data below the federal level. In addition, accounting skills, controls, processes, and infrastructure are weak across the board. The CGA's central role in accountability has yet to be fully recognized consistent with the requirements of the law, although there has been an improvement in the timeliness of preparation of Appropriation accounts and Consolidated Financial statements for audit over the past three years. Currently, in some instances, project directors, programme administrators and Principal Accounting Officers do not or cannot make effective use of financial data and reports in their decision making to ensure proper use of funds in producing results and outcomes due to capacity constraints. PIFRA has suffered from delays in the past but the implementation is now advancing satisfactorily. Improvements in internal audit and control systems in public enterprises will need to be reinforced in order to reduce losses being incurred by some public enterprises.
- *External Audit* skills and infrastructure are generally uneven. There is a shortage of staff with adequate skills, especially in certification audits. Given the wide range of responsibilities of the AGP, substantial modernization is needed in staff recruitment, assignment, training, and advancement practices. Audit quality has improved significantly over the past two years. The Auditor General's reports on the annual accounts are heavily qualified and refer to many breaches of financial regulations and controls. The vision to move beyond compliance auditing to systems and performance auditing, however, is heavily dependent upon appropriate risk-based categorization and management, and on accurate information recording under PIFRA in an IT-based environment.

- *Legislative Oversight* has been fairly effective when oversight committees (PACs) have been functional but long breaks in the accountability cycle have resulted in accumulation of considerable backlog of pending audit reports, despite improvements registered since the Ad hoc PACs were established. This risk needs to be addressed since effective oversight is a vital link in the accountability chain and, whereas, weak oversight tends to reinforce weak institutional practices.

Resolution of these issues would increase the effectiveness of public expenditures and lead to increased investor confidence. Additionally, the GoP recognizes that the current nature of public expenditure has seriously squeezed service delivery. The PER shows there are prospects of greater flexibility because of increased revenues and lower interest expenses. However, making better use of available budgets through improving financial accountability and reliability and more effective public service delivery are key to making good use of the larger fiscal space. Re-allocated public spending is necessary to overcome gaps in needed delivery of the quantity and quality of public goods.

## Conclusion

This Country Financial Accountability Assessment concludes that there are substantial opportunities for consolidating current reforms and for introducing additional reforms to further strengthen public financial accountability. This will require sustained policy level commitment. The Government's will to reform is evidenced by the scale and variety of actions underway at the Federal and provincial levels. The Government of Pakistan has already embarked upon wide ranging reforms to improve budgetary and accounting systems and internal control arrangements. These reforms are now starting to show results:

- The risks of revenue shortfalls have been reduced with the initiation of tax policy and tax administration reforms
- The risks of increasing excess debt have been reduced by more controlled budgeting and debt management through the use of the MTBF and the establishment of the Debt Office
- The risks of late and inaccurate federal annual accounts have been reduced by improved accounting controls introduced by the CGA in compilation of accounts and the Fiscal Monitoring Committees in encouraging reconciliations
- The risks of limited transparency in accounts at all levels have been reduced by the decisions to give the Auditor General responsibility for certification audit of all annual government accounts.

There has been substantial progress in strengthening the financial system and public accountability both at the federal and provincial levels. With the deepening of the current reforms and improved implementation of the PIFRA program, fiduciary risk to the Bank, other donors and government funds managed through mainstream accounting, financial reporting and internal controls systems has become minimal. In the light of these positive strides, coupled with improved expenditure tracking, the structural adjustment loans disbursed and managed through reliance on government-own financial management systems have shown satisfactory outcomes. However, to completely migrate away from 'ring fencing', there is still need to building capacity for transiting to *full* reliance on government systems, controls and reporting.

Several of the reforms measures rely on the widespread implementation of a complex automated accounting system in an environment of poor technical skills and infrastructure. The PIFRA implementation will require continued strong management support over a significant timeframe, and needs to be further accelerated to achieve its full objectives. Budgetary support loans and credits will need

to include comprehensive measures to consolidate and strengthen the improvement in PFM systems so that fiscal data can be tracked more reliably through all tiers of government.

## Key Actions Recommended

To build the necessary PFM capacity expeditiously, the GoP should intensify its work with the provincial governments in a broadly-based overall Financial Management Improvement Strategy and Program to move forward on capacity building, including training for improving organizational efficiency and effectiveness and institutional reforms. Also as noted in CFAA Phase one, capacity building is needed to develop foundation skills in finance, accounting, auditing, human resource management, and performance management. Continued emphasis on and consolidation of existing reform programs in the short term, in conjunction with new rules over the medium term, is needed to increase the effectiveness of intended reforms. These reforms are outlined and are prioritized in the Action Matrix at Chapter 5. The Matrix provides for a time-bound action plan aimed at moving forward on each of the specified capacity building and reform areas. Specific activities include:

- Improve the adequacy of current budget development processes for the Federal and provincial governments through more realistic budget development and implementation. The right-sizing processes developed by the GoP need to be fully incorporated
- Improve budget execution through stronger action to implement the Accountable Financial Management Framework agreed with the IMF to meet essential fiscal transparency standards
- Strengthen accounting expertise across the board. Modernize accounting and financial reporting in conformity with international public sector accounting standards and increase attention to performance. Complete introduction of Chief Financial Officers to assist Principal Accounting Officers. Create internal audit units to verify and improve internal controls. Finalize the CGA's control over organization, staffing, and training arrangements with clearly defined roles and responsibilities for staff reporting
- Clarify key accounting devolution issues and build capacity before major fiduciary responsibilities are shifted. Accelerate PIFRA computerized accounting system implementation and extend the New Accounting Model and a simplified system for lower levels of government, as required, through all tiers of government to provide a sound underpinning of record keeping
- Develop training and certification programs for the Auditor General's Department based on a solid foundation of accounting and auditing knowledge and proficiency. Formulate a comprehensive Institutional Development Plan for strengthening the Auditor General's Department including the external audit work program, risk-based audit practices, methodology, organizational structure, and human resources strategy
- Build awareness, information sharing, and technical capacity of review committees in the legislature through strengthening programs at Federal and provincial levels to improve legislative scrutiny. Amend relevant practices to clear backlogs and allow greater public access to PAC findings. Improve PAC oversight by legislative debate and formal government response on its reports.
- To increase the likelihood of success, the GoP should entrust the Steering Committee with primary responsibility for further developing the action plan and marshalling the resources for its implementation. The World Bank, in partnership with other development agencies, will support

initiatives aimed at further developing and implementing the detailed action plan and will provide technical assistance, as requested. To be effective, however, the action plan must remain realistic and recognize the limited budgetary resources available, the competing demands on government stafftime, and the need for close and expert management to achieve the required reforms.

### **Expected Benefits**

The key challenge for the GoP and the provincial and district governments is to implement and sustain the wide-ranging on-going financial management, civil service reform, and devolution programs. Although considerable effort and perseverance is required, when the proposed reforms are implemented and consolidated, the following outcomes are expected:

- Improved financial management, budgeting, and expenditure controls are expected to enable closer tracking and reporting of actual funds usage and thus make the budget execution process increasingly meaningful
- Improved accounting and auditing capabilities are expected to reduce waste and enhance productivity leading to increased availability of disposable funds for enhanced poverty reduction programs
- Improved information is expected to increase managers' effectiveness in analyzing new proposals by considering full operations and maintenance costs, and leading to better investment decisions
- Improved oversight and public access is expected to increase accountability and fiduciary behaviors by legislators, government officials, and line managers to deploy resources in the best interests of stakeholders.

## 1. Budget Development And Execution

### Budget Development Bench marks

1.1. Major benchmarks for budget development provided by the International Monetary Fund's (IMF) Code of Good Practices on Fiscal Transparency include as good practice: budget documentation, final accounts, and other fiscal reports for the public sector which cover all budgetary and extra-budgetary activities of the central government; and well-defined and open budget preparation processes with emphasis on outputs and outcomes. Public dissemination of information is an important goal.

1.2. Budget revenue and expenditure estimates must be realistic with a disciplined process for fully costing new programs prior to introduction and include a framework for *ex post* accountability of fiscal policy and plans. There must be effective Parliamentary participation to ensure a strong linkage between policy and budget plans. Measures of success include a sustainable debt level, low fiscal deficit, coverage for unfunded public sector contingent liabilities, and an adequate level of social and economic development spending. Budget preparation processes must also be effective at lower tiers of government.

1.3. This CFAA relied on the recommendations of the World Bank Public Expenditure Review (2003) to address perceived gaps in the public financial accountability framework for budget development.

### Long Term Vision

1.4. In the next ten years, Pakistan would have:

- Staff fully trained in budget development and execution in all line ministries at Federal and Provincial levels
- Realistic processes for budget development with accurate forecasting of revenues and expenditures and at federal, provincial, and district levels
- Full and timely reporting and analysis of budget versus actuals with public and parliamentary disclosure of budget processes, figures, and outcomes.

### *Legislative Framework*

1.5. The 1973 Constitution delineates the expenditure responsibilities of Federal government (Federal Legislative List) and the areas of shared responsibilities (Concurrent Legislative List). All residual functions are the domain of provincial governments. Local government functions are defined under provincial laws through the Local Government Ordinances (LGOs).

1.6. Federal and Provincial Assemblies authorize expenditures on the range and composition of public services each fiscal year. The Constitution also provides for charged or obligatory expenditures on constitutional positions (such as the President, High Court Judges, Chief Election Commissioner, and the Auditor General) and for debt servicing.

### *Budget Development*

1.6 Budget development is based on well-defined timetables in the Federal and Provincial Governments of Pakistan. On the expenditure side, circulars issued by Finance and Planning Departments initiate the preparation process 8-10 months before submission of the budget. Agencies are requested to submit a statement of: i) permanent expenditures on the current budget, ii) projected expenditures on existing development projects, iii) proposals for new expenditures, and iv) proposals for expenditures on new development projects.

1.7 By December-January each year, line departments submit budget proposals after vetting by the Ministry of Finance (MoF) Financial Advisors. Negotiations between MoF, Planning Division, and the respective Ministries continue until March or April until such time as expenditure aggregates are consistent with revenue and foreign project assistance forecasts. Review of budget proposals varies greatly depending on whether the expenditures are fixed or new. Most of the current budget is treated as fixed and therefore, is not reviewed in detail unless there is an extraordinary change in estimates from the previous year. All establishment (*i.e.* personnel) and pension costs, non-allocable charges, debt servicing charges, and office administration fall under the category of fixed expenditures.

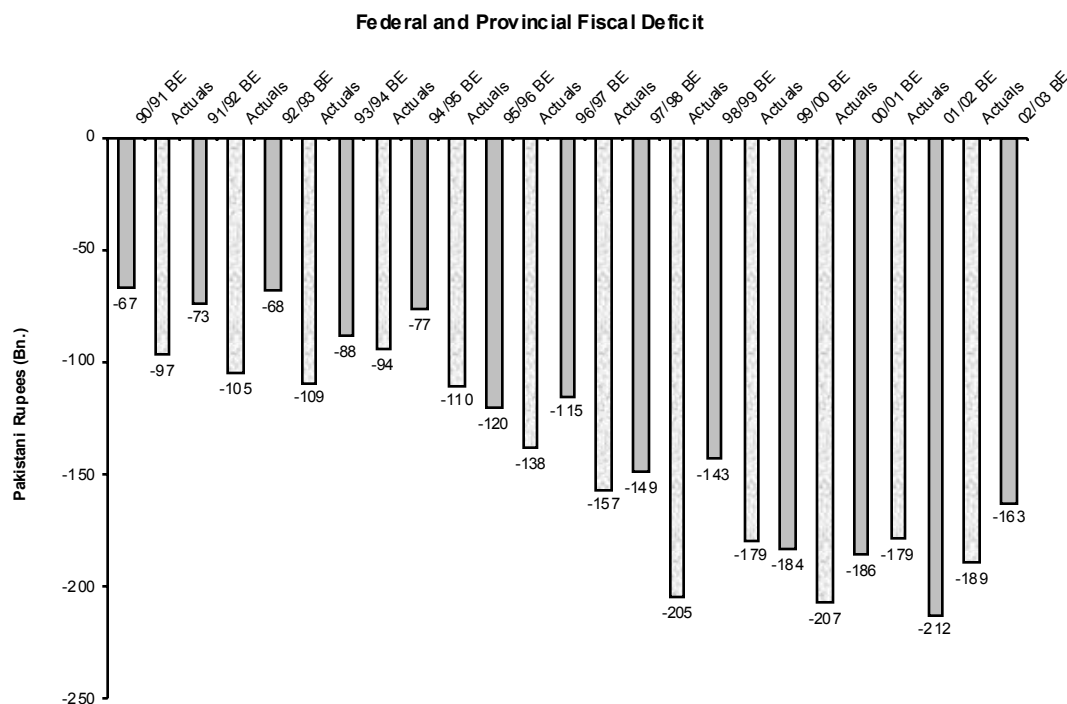
1.8 Budget-related discussions between the Government and the public vary. In the case of the Federal budget, pre-budget seminars are held by the MoF in the Federal and provincial capitals where private sector, academic, and Non-Governmental Organization (NGO) representatives attend. These seminars are not, however, followed through by feedback from the Government on how the discussions have been incorporated. Also, discussions on provincial budgets—which account for 80 percent or more of national expenditures on key service areas such as education, health, agriculture and irrigation, and public works—are more limited. Finally, there are less deliberated consultations between the Parliament and the public over the budget.

1.9 Preparation of the budget on the revenue side is based on estimates provided by the Central Bureau of Revenue (CBR), the Department of Income and Excise Taxes at the Federal level, by Boards of Revenues at the Provincial level, and by other revenue collecting agencies. These estimates are in turn based on projections of economic and income growth during the year. Aggregate resource availability is also based on estimates of external funding flows, disbursement of foreign aid, and an assessment of domestic financing flows.

1.10 Major reforms in budget development are now underway by the GoP. Annex 1 provides a listing of ongoing reform efforts. On the revenue side, the Bank and IMF are strengthening the CBR, including upgrading computerization, reorganizing functions, recruiting qualified professionals, and upgrading academic qualifications to be attained by staff. Reform actions include: an ambitious devolution program, increased fiscal transparency, formulation of the Draft Fiscal Responsibility and Debt Limitation Law, and the initiation of a medium-term budget framework (MTBF) in conjunction with the IMF. The CBR has significantly modified its rules in order to reduce exemptions and Statutory Regulatory Orders and to make them more transparent. These orders, which exempt some enterprises from taxes, are now industry-specific and none are entity-specific thereby reducing misuse of the power. As a result of the reforms, about 6 percent annual revenue growth is ascribed to the reforms by the CBR.

## **Current Budget Preparation Arrangements**

1.11 During the 1990s budget deficits were larger than planned. In ten of the past twelve years, receipts fell short of estimates. In six of the past twelve years, expenditures exceeded spending estimates—further deepening the fiscal deficit as shown in the chart below. Of course, there are many reasons for this; but weaknesses in management of receipts and expenditures are among them.



Source: Economic Survey of GoP (various issues), nominal rupees.

The shortcomings of the budgetary system are linked in part to lack of capacity. Rigidities in expenditure structures, absence of performance orientation, insufficient coverage of development projects and public enterprises, and uneven quality and classification of accounts are some of the features that have characterized past Government budget management processes in Pakistan.

1.12 At the Federal Government level, there have been persistent high deficits, increases in nominal public debt, and inadequate funding for some public services. In addition, public sector wage budgets were inadequate. Interest payments were, at times, underestimated on accrual and cash basis. Details of military expenditures, guarantees to public enterprises, and accounting of quasi-fiscal transactions were not disclosed. Although Federal Government financing of public enterprises in power, transport, water, gas, oil, and banking is substantial, contingent liabilities on guarantees or funds allocated to Public Enterprises (PEs) and independent power producers, and financing of operational losses have not been fully covered in the budget.

1.13 At the Provincial government level, expenditures on civil service salaries, pension obligations, and debt servicing have accounted for more than two-thirds of all expenditures in recent years, thereby crowding out allocation for goods and services, maintenance, and public investments.

## Budget Execution Benchmarks

1.14 Good public sector budget execution processes aim to achieve transparency and accountability in budget implementation to ensure efficiency and effectiveness in public resource utilization. There is need for more clarity and enforcement of roles and responsibilities within the public sector, emphasis on reliable budget management processes including predictable funds flow to spending units, and effective accounting systems and managerial decision support systems.

1.15 Measures of success include improving resource allocation through budget monitoring processes that lead to more efficient delivery of services, reducing waste, and transitioning toward effective fiscal decentralization. Facilitation of a vigilant and informed media can play an effective role in enhancing transparency along with ensuring responsiveness to the public regarding budget development and execution.

### **Current Budget Execution and Monitoring Practices**

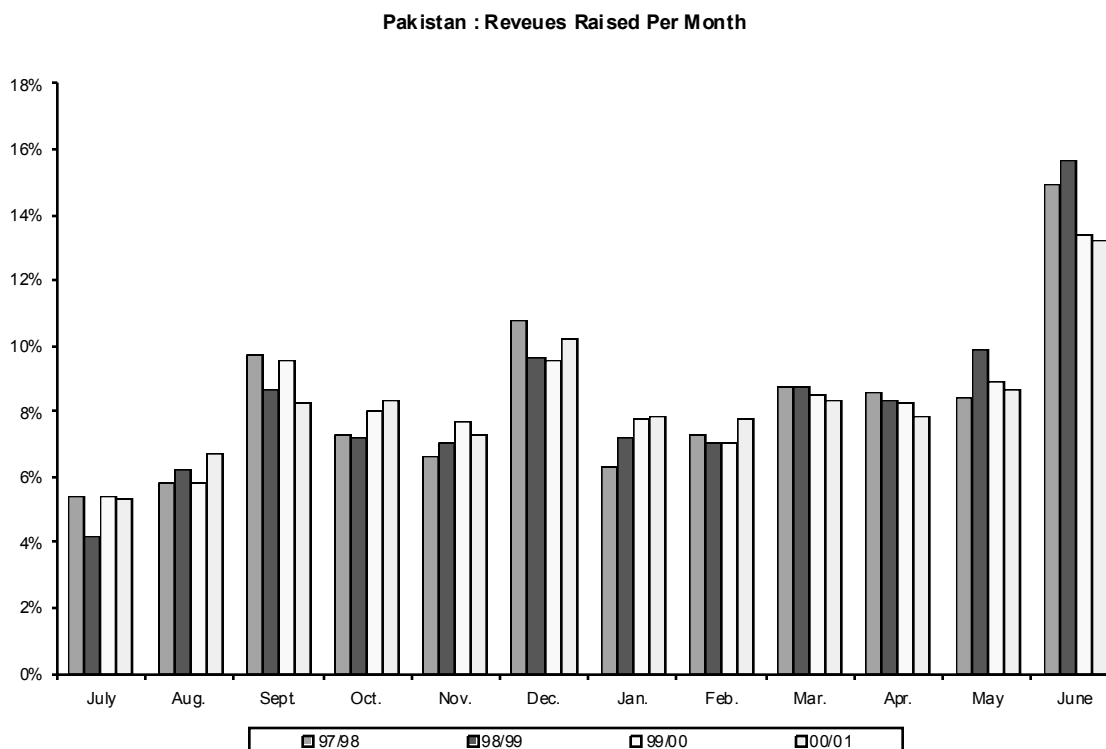
1.16 There are some weaknesses in budget execution activities in Pakistan because allocated funds have sometimes been insufficient. This is often due to resource constraints. Overall, budget execution has improved but still needs to be strengthened with releases that are timely and allocated as planned. Even when budget allocations were sufficient, the timing of funds flows between levels of government below the federal level was often unpredictable. Off-budget accounts and other short cuts have emerged to speed funds to essential programs, but these irregular practices decrease the government's ability to accurately track and report on fund usage and related outcomes. For 2002-2003 no cuts were imposed on the estimates provided by the various ministries and total allocated funds were released to those ministries.

1.17 The government has made significant progress in establishing an integrated financial management system under PIFRA—the first computerized District Accounting Office in Abbottabad is in full production mode. Under the reform program instituted in connection with the World Bank's SAC II, data availability has improved, for example through posting of monthly and quarterly Federal reports on the government's website, and sending of budget execution data to ministries by mid-month for reconciliation. Budget call circular was issued to request estimates for 2003-2004. The information is being further processed and tabulated under NAM.

#### *Release of Funds*

1.18 After legislative and executive approval of the Budget Law/Finance Bill, Finance Ministries/Departments send a release letter to Ministries, Departments and Agencies and their respective offices of the Accountant General of Pakistan Revenues (AGPR) or Accountant General (AG) advising that funds are being made available against their budgets. AGPR/AG offices in turn inform district accounting/treasury offices of the availability of their funds. Finance Departments and Divisions maintain ledgers noting the initial budget disbursements and their subsequent adjustments. As of July 2000, the New System of Financial Control and Budgeting (NSFCB) delegated more powers to administrative units. It makes the Secretary of the Ministry/Department and the Principal Accounting Officer (PAO) explicitly accountable for the proper implementation of the Budget, except in cases where Secretary or PAO is overruled by the Minister.

1.19 Under the NSFCB, the federal government releases funds at specific intervals, according to specific formulae and percentages. A help line in the Budget Wing is being established to assist the implementing agencies in release of funds at any stage. The Provinces release allocations to district governments on the first of every month so that funds are available for the coming month. Revenues raised per month are indicated in Figure 1.1.

**Figure 1.1. Pakistan : Revenues raised per month, 1997/98-2000/01.**

1.20 In the past, Personal Ledger Accounts (PLAs) and Assignment Accounts (AAs) were authorized by the Ministry of Finance to facilitate quick payments in special cases. Ministries open PLAs or AAs with Treasury or National Bank of Pakistan (NBP) respectively. Under advice to the Accountant General, the Ministry of Finance releases funds into these accounts. The operators of these accounts have checkbooks and can make payments without undergoing normal pre-audit procedures. Checks from PLAs are required to be cleared against the overall budget of the PLA by Treasury before payment while checks from AAs are presented to and paid by NBP. The operating entities are required to maintain detailed accounting records to support the transactions of these accounts but this is not always done.

1.21 Although these accounts were intended to be exceptional, they have proliferated. It was reported that in Punjab alone there are over 1,200 such accounts. Because they can be used to hold funds to avoid their lapse at the end of the year, these accounts can potentially distort fiscal data and reporting on budget execution, and are, therefore, being discouraged by the Government to prevent funds from being held unnecessarily. The CGA has issued instructions that such accounts should only be opened under exceptional circumstances, even for donor-financed projects. Efforts are being made so that every expenditure is budgeted and accounted for.

### *Budget Implementation*

1.22 Ministries/Divisions are required to send a monthly statement of expenditures to the MoF through the Financial Advisers. A mid-year review of the budget based on reconciled accounts is conducted so that a strategy for budget implementation for the remainder of the fiscal year can be formulated. There are clearly established procedures for approved reallocation of expenditures from one line item to another. The PAO has the power to reallocate funds within the department below a certain threshold. Reallocations

above a certain threshold and transfers between major budget heads must be approved by the Ministry/Departments of Finance at the time of each month's reconciliation processes.

1.23 In-year flexibility for the budget process is provided by use of the six- and nine-month lists of excesses and surrenders, and by the use of supplementary grants for essential expenditures. If funds for excess expenditures are not available within existing grants then a supplementary grant can be approved by the Finance Department on a temporary basis. All supplementary grants are subject to approval by the legislature either under a supplementary budget or a revised budget. This is approved by the Parliament at the time of the next year's budget

1.24 Current taxes are being levied at the Federal and Provincial levels while Districts, Tehsils, and Union Councils have their own levies. Annex 2 presents an analysis of Public Expenditure Management under devolution, with a focus on Sindh. To help ensure appropriate distribution of fiscal resources, a divisible pool has been created into which the net proceeds of specified taxes collected by the Federal Government are credited for sharing between the federation and the provinces.

1.25 The government is deliberating on proposals of the Provincial Government to establish new sharing arrangements. This is of crucial importance as approximately 95 percent of total revenues are raised at the Federal level with only 5 percent being raised by the Provinces. Federal transfers make up all but 17 percent of the provincial revenues. Development expenditures are 11 percent of total expenditure at provincial level, 19 percent at Federal level, and 17 percent overall. Table 1.1 shows provincial government account balances for 2001-02.

**Table 1.1: Provincial Government Operations 2001-2002**  
(Provisional—Million Rupees)

<i>Item</i>	<i>Balochistan</i>	<i>N.W.F.P.</i>	<i>Punjab</i>	<i>Sindh</i>	<i>Federal</i>
<b>Total Revenue</b>	<b>24,611</b>	<b>34,989</b>	<b>108,879</b>	<b>63,209</b>	<b>448,390</b>
Provincial share in Federal revenue	16,709	19,223	85,465	50,070	
Tax revenue	490	1,456	9,483	7,204	286,540
Non-tax revenue	1,796	7,508	8,269	3,803	161,850
Federal Loans (net)	574	2,903	2,409	(2,180)	
Federal Grants	5,043	3,899	3,254	4,312	
<b>Total expenditure</b>	<b>24,575</b>	<b>34,805</b>	<b>101,743</b>	<b>71,883</b>	<b>695,255</b>
Current expenditure	20,823	29,803	92,659	64,508	561,313
Development expenditure	3,753	5,002	9,084	7,375	133,942
<b>Overall balance</b>	<b>36</b>	<b>184</b>	<b>7,136</b>	<b>(8,674)</b>	<b>(246,865)</b>

Source: Federal and Provincial Finance Accounts 2001-2002.

1.26 On the development expenditure side, budget execution within line departments has sometimes suffered from deficiencies in booking to the correct expenditure codes which led to circumvention of financial procedures. Controls are in place to reduce incorrect bookings to salary codes but other codes have fewer restrictions to limit improper bookings. Expenditure during the year on the non-development budget is controlled through the staged release of budgetary funds as per the NSFCB and through restrictions on certain spending such as purchase of vehicles in the current financial year.

1.27 Implementation and reporting of development budgets represent particularly difficult problems especially in cases where special PLAs and AAs are employed. This leads to internal control and monitoring issues.

1.28 The reform program included establishing Fiscal Monitoring Committees (FMCs) at the Federal and Provincial levels to monitor budget execution and review trends in budget implementation; reforms in accounting, internal controls, public auditing processes; and public disclosure of budget information. Regular FMC meetings are being held to resolve stakeholder issues. These committees have been effective in reconciling accounts and timely rendering of reports. However, these committees need to be strengthened in order to meet the continuing challenges ahead to implement the reform program at the Federal level and to introduce reforms at the sub-national level.

### *Budget Management in the Provinces and Districts*

1.29 Problems of budget implementation and *ad hoc* cutbacks in expenditures occur in the Provinces. Because of limited initial budget development and prioritization and limited borrowing powers, reallocations and re-appropriations during the year are sometimes required. Since 2002-2003 efforts are being made to enhance and maintain allocations for priority social sectors that are critical to poverty reduction goals. Lack of monitoring and evaluation of expenditures on a timely basis and the absence of a body with clear responsibility to monitor the budget and take corrective actions hinder effective budget execution.

1.30 Under devolution, the Executive District Officers for Finance & Planning are responsible for ensuring that there is proper financial management at the District level. They are, however, somewhat unsure of their roles and responsibilities for: i) issuing sanctions for non-salary funds, ii) performing timely reconciliation of expenditures between the District Accounts Office (DAO) and the line departments, and iii) performing internal audit functions. There is a need to provide training to the staff as many of them are not financial experts.

1.31 The NWFP Provincial Financial Accountability Assessment (PFAA) signals specific issues regarding release of funds and development projects.

### *Other Budget Implementation Issues*

1.32 In addition to the issues and weaknesses discussed above:

- Existing processes, procedures, and systems have not focused sufficiently on providing intra-year financial information to the executive to manage the budget
- On development projects, there have been: i) delayed releases and procurements caused by inaccurate estimation of revenues and/or transfers of funds to other priorities, ii) unapproved design changes during implementation, iii) uneven efforts to monitor physical progress, and iv) inadequate recurrent budgets for projects contributing to arrears
- Budget execution is usually per estimates. Sometimes the estimates are revised according to developments occurring after budget publication but the social sector expenditures are protected.

## Recommendations

1.33 With the exception of reference to the continued implementation of the IMF Accountable Fiscal Management Framework, the recommendations presented below are limited to actions considered useful to strengthen weak points revealed by the analysis. They take as given the many activities already underway as part of the public financial management reform program. Recommended actions are:

- Clarify fiscal framework and resource allocation between the three tiers of government in the National Finance Award and Provincial Finance Awards
- Publish a self-contained, up-to-date manual describing federal, provincial, and local budget procedures with common formats under NAM. Develop performance indicators for the social sectors in Provincial budget documents and relate the financial inputs with physical outputs
- Improve budget realism and comprehensiveness by fully identifying contingent liabilities debt, and long-term liabilities such as pensions. Include provincial off-budget items as well as all foreign-funded development expenditures in budgets
- Strengthen the FMC to carry out the full functions set out in its terms of reference
- Train staff within the line Ministries, in order to overcome defects in budget execution, including, for example, funds approvals, tendering and procurement procedures, tracking of development financing and departmental budgets, reconciliation, and overall record-keeping. Delegate budget making and re-appropriations to the local governments and provide appropriate staff training
- Improve accountability and quality of service by increasing awareness through media dissemination to make budgetary information more transparent at local service delivery sites.

## 2. Public Sector Accounting, Financial Reporting and Internal Control

### Benchmarks

2.1 Key principles for good accounting, financial reporting and internal controls are the: i) quality of the accounting environment and the accountability chain within the civil service and PEs, ii) ethical framework and competence of staff assigned to the functions; iii) clarity of roles and responsibilities; iv) scope of accounting and internal control policies and procedures; v) capacity and reliability of accounting information and records management systems to provide timely, comprehensive, reliable, and accurate information; and vi) adequacy of monitoring and risk assessment systems.

2.2 In theory, with devolution of government functions and powers to departments and local government, public services should better match local demand and Government should be more transparent and accountable in its performance. But in the early stages, devolution can potentially pose risks that need to be managed because it provides funds to levels of government that may not yet have the capacity to perform the required services.

### Long-Term Vision

2.3 In the next ten years, Pakistan would have:

- Complete annual financial statements for each tier of government according to the New Accounting Model (NAM) within three months of the end of the fiscal year, and their audit and presentation to the legislatures within six months of the end of the fiscal year
- Full implementation of the integrated computerized accounting system with automated reconciliations and decision support capabilities for managers
- Consolidated Financial Management Strategy and Improvement program to provide overall direction and focus on needed reforms and to coordinate accounting and budgeting reform
- Accounting, internal control, and internal audit framework as per International Public Sector Accounting and Auditing Standards and best practices at all levels of government
- Adequately trained, effective accounting work force at all levels of government
- Full adoption of selected Public Sector International Accounting Standards.

### Description of Current Accountability Arrangements

#### *Legislation*

2.4 Article 170 of the Constitution provides that accounts of the Federation and Provinces shall be kept in such form and in accordance with such principles and methods as the Auditor General may, with the approval of the President, prescribe. The authority that the Auditor General of Pakistan (AGP) exercises in this domain is subject to certain basic parameters in the Constitution, in particular the

framework of a Consolidated Fund and Public Account (Articles 78, 118) and the contents of the Annual Budget Statement (Articles 80, 120).

2.5 In May 2001, the GoP enacted a Controller General of Accounts (Appointment, Functions and Powers) Ordinance replacing the Pakistan (Audit and Accounts) Order 1973. The new Ordinance transfers the responsibilities for the preparation and maintenance of the accounts of the Federation, the Provinces, and districts from the Auditor General to the CGA, who is separately appointed by the President. Based on Article 170, the AGP prescribes accounting principles and methods. Under the CGA Ordinance, the CGA has the responsibility for laying down the principles governing internal financial control for Government departments, in consultation with the Ministry of Finance and the Provincial Finance departments as the case may be. It is important that the issue of administrative control in respect of the Accountants General (AGs) is resolved in accordance with the established law at the earliest.

2.6 The Federal, Provincial, and District Governments; Tehsil Municipal Administrations; and Union Administrations are separate accounting and reporting entities. Federal and Provincial governments each have one Consolidated Fund into which all revenues, borrowings, and repayments of loans from the Government are paid and out of which all public expenditures are made. Each also has a Public Account for moneys received by the Government for which it has a fiduciary responsibility but which it is not at liberty to appropriate for the general services of the Government. Public Account moneys comprise trust accounts (normally established under special laws) and special deposit accounts such as for relief funds, civil and criminal court deposits, contractor's deposits, welfare funds, and development funds. Both these accounts are maintained with the State Bank of Pakistan (SBP). Single accounts have been created for each of the new district governments.

2.7 Spending entities are permitted under certain circumstances to open separate bank accounts (Assignment Accounts) with the National Bank of Pakistan upon the approval of the Ministry/Department of Finance, and funded from the Consolidated Fund or Public Account. The main users of Assignment Accounts are self-accounting entities and development projects. Although these accounts may help overcome cash flow problems, they have caused difficulties in compiling comprehensive fiscal reports due to budget and fund separation practices and their operation is discouraged by the CGA and the AGP.

2.8 The legislation governing the organizational structure, management, and fiscal powers of local government bodies is contained in the Local Government Ordinances (LGOs) promulgated by the Provincial legislatures. The LGOs identify the regulatory and service delivery functions of the bodies. The execution of these functions will be financed by: i) taxes levied and collected by the district government and TMA, ii) taxes levied by District Governments but collected by central agencies, and iii) transfers of tax revenue and other grants from the Provinces to the districts. These transfers may be unconditional or conditional (assigned for special functions) and partly based on matching grants.

2.9 Under the Federal Ordinances, accounting for and auditing of local governments were brought under the CGA and the AGP. Previously, local bodies had been responsible for their own accounting, and pre-audit had been provided in district councils and municipal corporations by a resident member of the Provinces' Local Fund Audit. The amendment to the LGO changes these arrangements so that Accounts Officers perform pre-audit functions and auditors certify financial accounts. Interim arrangements are in place until the changes in the Ordinances can be fully adopted.

### *Responsibilities for Accounting, Reporting and Internal Control*

2.10 Pakistan has the necessary elements of a good internal control environment: a clear accountability chain from the individual civil servant to the Secretaries of the Departments who, as PAOs, are

accountable to the Ministers and the PACs. The Departmental Accounts Committee (DAC) is a forum where representatives from the Department, Ministry of Finance, and AGP can play an important role in improving internal controls and acting on audit findings by monitoring reports and ensuring resolution of findings. Regular meetings of the DAC are held to monitor processing of relevant Audit & Inspection Reports and to decide upon appropriate measures to aid and accelerate finalization.

2.11 Although there are Financial Advisors (FA) working under the Ministry of Finance, assisted by Deputy Financial Advisors, they typically have oversight responsibilities for several ministries each. As well as reviewing budgets before submission to the Ministry of Finance, they are also charged with monthly monitoring of sanctions and expenditure in the ministries. In addition, they provide advice to the ministries on financial matters as and when required. The FA initiative is being supplemented by the introduction of Chief Financial Officers (CFOs) in the ministries. In November 2002, the CGA recommended the introduction of CFOs to assist PAOs with issues relating to financial propriety of expenditure and receipts, internal controls, reconciliations, DACs, and PACs.

2.12 A key link in the accountability chain is well trained accounting staff at all levels—with solid technical skills for both existing and new staff. Civil servants assigned to accounting functions are from the Pakistan Accounts and Audit Service (PA&AS) which has entry and ongoing professional development requirements intended to ensure levels of technical competence. Another stream of professional flows from the SAS Qualified accounting and auditing staff. These are the accounting technicians who through professional experience can occupy senior positions.

2.13 There are systems of individual performance evaluation and comprehensive rules have been set regarding ethical conduct of civil servants. Among other things, all civil servants are obliged to declare their assets each year and are prohibited from conducting business or entering into agreements that may conflict with official duties. When combined with professional recruiting programs, improving training and certification requirements for existing account staff will significantly enhance the overall accountability framework.

2.14 The CBR has reformed its recruitment processes through requiring more specialist expertise and experience for recruitment. Offering external professionals the opportunity to enter into the normal stream along with the usual perquisites and promotion chances could be effective in attracting professional accountants to government service. Reforms to the Civil Service are now under consideration by the GoP.

### *Accounting and Reporting*

2.15 There is an overall framework of accounting and financial reporting overseen by the AGPR for Federal Accounts and General AGs for the provincial accounts. All these functions report to the CGA at the federal level. Presently, preparation of accounts starts with the DAOs carrying out pre-auditing and accounting functions. For these cash basis accounts, the requirements include approving payment requests, submitting monthly statements of Federal and Provincial receipts and expenditures, enforcing account and bank reconciliations, and preparing reconciled annual statements for the District.

2.16 The current manual systems are designed to capture expense categories such as salaries, travel, and equipment for each accounting entity. Detailed expenditure analysis by function is available with the District Accounts Offices. Service delivery and other operational data is available with the line departments. Preparation of Statements of assets and liabilities conforming to international accounting standards has been provided for in the New Accounting Model.

2.17 The AGPR and Provincial AGs prepare monthly accounts of receipts and expenditures by detailed line items using accounts sent by the DAO. In a parallel process, line Ministries and Departments also prepare accounts based on reports sent by the Drawing and Disbursement Officers. Ministries and Departments are then required to reconcile these expenditures with the offices of the AGs each month. The reconciliations have stabilized at the Federal level and are improving somewhat in the Provinces.

2.18 During 2001-2002, some minor difficulties relating to timeliness of reporting were registered. While the CGA was able to prepare the Federal accounts for 2001-2002 within six months of the end of the year, there was some slight delay in finalizing the provincial accounts due in part to a lack of full coordination between some Provincial AGs and DAOs and inefficiencies in some District Accounts Offices. Accounting for transfers from Provincial funds to the District governments and accounting by local governments for the use of funds both caused difficulties but this has now been remedied. There is also a need to improve DAO reporting for monthly accounts which are still not sufficiently timely or accurate due to the use of largely manual, cash-based transaction accounting methods with associated high risk of errors and time lags. The absence of accurate records of assets, commitments, and information on loan and grant transactions made directly by donor agencies compounds the problem.

2.19 The FY 2001-2002 accounts have substantial un-reconciled discrepancies. The FY 2000-2001 Finance Accounts showed substantial un-reconciled differences between the books of accounts and the bank accounts balances at 30 June 2001. The overall outstanding difference for all Finance Accounts was 12.4 billion rupees. This is symptomatic in situations of high volume manual transactions and lack of electronic interfaces – one that PIFRA implementation is already initiating to address. In the meantime however, there have been significant improvements in reconciliations at the federal and all provinces levels since after 2001-2002.

#### *Internal Control and Internal Audit*

2.20 The reports of the Auditor General point to numerous instances across government of: i) non-compliance of expenditure approvals with budget limits, delegation between authorities, and requirements for proper documentation of expenditures, ii) misclassification of expenditures, and iii) instances of fraud and misuse of public funds and assets.

2.21 Pre-audit expenditure approval processes are not as timely as they should be and that in some cases strict instructions on processing times need to be instituted. It has been reported that pre-audit has led to dysfunctional practices. In lieu of pre-audit, a modern accounting system is needed that separates authorizing and certifying functions within the line process supported by proper record keeping, internal and external audit scrutiny, and disciplinary processes.

2.22 In many instances, compliance with existing internal controls and procedures has been found to be inadequate. In general, Government ministries/departments do not have an internal audit function within their organizations. Audit functions are largely left to AGP, the external auditor. In addition, there are no formal procedures to ensure effective risk management at the departmental level. The review that resulted in the separation of auditing from accounting functions also involved the preparation of a draft Ordinance for Internal Control. An internal control framework covering the control environment, risk assessment, control activities, communication, and monitoring should be established in all government offices. There should be a process to check the adequacy of internal control systems that are in place including inventory and asset management processes.

2.23 The Government has recognized that its manual accounting system has weaknesses which require improvements to provide timely, accurate, comprehensive, and reliable information for informed decision making and for effective accountability. In response to significant past problems with reconciliations,

Fiscal Monitoring Committees comprised of Finance ministries, the Accountant General's office, and State Bank representatives have been established by the Federal Government and all four Provincial Governments to ensure that accurate fiscal accounts are prepared and reconciled. Reconciliation of expenditures with financing by the SBP, the NBP, and non-bank sources such as the National Savings Schemes also takes place under the direction of the FMCs. It may be reiterated here that the PIFRA provides for a component activity that shall support full automation of the reconciliation process on real time basis and thus remedy the existing lapse associated, largely, with manual reconciliations of large volume of transactions.

### *PIFRA*

2.24 As part of PIFRA, replacement of manual accounting processes by computerized processes using SAP application is underway in pilot installations at the Federal, Provincial, and District levels. Under PIFRA I, 52 sites are expected to be operational. Under the PIFRA II project, 75 remaining planned sites are to be automated, thus catering for a cumulative total of 127 sites. The computerization as originally envisioned under PIFRA I is planned for core accounting units under the CGA and for Departments of Finance. Operational Acceptance Tests have been completed for the Federal MoF and the NWFP, Punjab, and Sindh Finance Departments. Operational Acceptance Tests have also been completed for AGPR Islamabad, AG NWFP, and AGPR sub-office NWFP where data migration is in progress. In addition, Operational Acceptance Tests have been completed for AG Sindh, AGPR sub-office Sindh, and DAO Hyderabad. The Abbottabad site is currently operating at full production level and is providing financial statements which are being successfully consolidated by the AGPR.

2.25 The complete rollout of PIFRA systems will eventually provide the basis to modernize approval and reporting processes and standards. While the GoP has expressed a strong commitment to redeveloping the accounting system of the Federal and Provincial Governments, progress until recently has been slow. But reliable and comprehensive schedules for PIFRA implementation across the sites need to be set and met.

2.26 Self-accounting entities generally already have systems in place; these emerging requirements would therefore need to be assessed either for interface systems or for PIFRA extensions—based on capacity and technical considerations. The SBP uses an Oracle applications banking package that covers the federal and provincial accounts. The issue of integration at the provincial and national level with SAP applications and Oracle databases needs to be addressed by a coordinating committee to discuss and resolve these and other IT issues, and specifically to address ABD's work in the districts. Since the original PIFRA design did not envision the specific requirements of local governments, potential automation of tehsils and Union Administrations under the proposed devolution plans should be urgently examined.

2.27 The PIFRA roll-out process needs to look at automating controls through business process re-engineering, dropping unnecessary activities, and providing strong monitoring of approval delays through reports to upper management or oversight bodies, but not to direct supervisors who can easily collude. After significant progress has been made with strengthening internal controls, the relevant Audit Committees should report to the CGA on the scope for revisions to the systems of pre-audit to improve the efficiency of the accounting and overall internal control framework. This work should be supported by an assessment under PIFRA.

2.28 In addition to the new computer system, a New Accounting Model (NAM) containing a new chart of accounts and detailed accounting and financial reporting guidelines will support the fully automated accounting system. The NAM is currently being piloted at the Federal level and in NWFP. Full implementation of the NAM is subject to the approval of the Federal MoF. The new chart of accounts is

broadly consistent with the IMF's revised GFS system and, with suitable bridging tables, will enable the Government of Pakistan to comply with international reporting obligations under the cash basis of accounting, although the system also caters for a modified cash basis accounting system. In the interim, until the implementation of the computerized accounting system and NAM is completed, the existing governmental accounting processes and Chart of Accounts have been proposed for use in local governments to increase consistency of accounting and reporting.

2.29 The International Federation of Accountants published its International Public Sector Accounting Standards (IPSAS) Financial Reporting under the Cash Basis of Accounting in January 2003. It defines the cash basis of accounting, establishes the mandatory requirements for the disclosure of information in the financial statements and supporting notes, and addresses several specific reporting issues. Action to develop consolidated statements of financial assets, as useful additional information to the Cash Basis of Financial Reporting, and based on generally accepted valuation principles is also needed and should be formulated as part of PIFRA 2 or a comprehensive financial and asset management reform program.

### *Devolution Considerations*

2.30 The existing financial management processes at the local government levels are basic. Financial reports and final accounts, mostly based on manual accounting procedures, are often untimely and incomplete. Audits have a limited coverage due to lack of data, resources, and staffing capacity. Required changes in the accounting procedures and the annual audit of all districts, tehsils/towns and union councils are a major increment to the workload of the CGA and AGP resources.

2.31 While the overall fiscal devolution process is underway, the opportunities and risks of devolving accounting functions to the provinces and to the local governments need to be clarified. The Constitution provides Federal responsibility through the AGP to determine the principles and methods of accounting. However there are conflicting views among the AGP, CGA, and NRB as to the responsibilities of keeping the records and preparing the accounts under the proposed devolution framework. This issue needs to be clarified and communicated quickly by the Government of Pakistan to all interested parties to avoid further confusion.

2.32 In early 2002 there was an intention to assign the provincially controlled staff in the DAOs/Treasuries to report to the CGA. The NRB was to help the Provinces issue letters assigning the DAOs to the CGA. Full CGA control of the DAOs would help to instill control over expenditure that goes through the DAOs during any transitional processes. The issue of staff transfers also needs to be fully resolved for any devolution arrangements.

2.33 As the Government decides this issue, there is also a need to assess the opportunities and risks of decentralization of accounting functions to more departments of the Federal and provincial Governments, taking into account requirements for minimum qualifications needed for appointment, transfer or promotion; minimum training needs for unqualified incumbents; and objective criteria for departments to demonstrate accounting proficiency in advance of devolved responsibilities. The current capacity of local governments to prepare medium-to-longer term policy options on key financial management issues and to monitor the implementation of related reforms is weak and requires major capacity building efforts. In particular, improved skills and managerial capacity are needed to develop more efficient resource allocation and expenditure utilization structures along with related controls required for maximizing service delivery. The Ordinance has called to establish Accounts Committees at the district level. This is a welcome move but has significant requirements in terms of building the capacity of these committees.

## Recommendations

2.34 As indicated in the CFAA Part 1, the GoP was to prepare an action plan to ensure that there will be: i) adequate budget and accounts staff with the right skill mix and appropriate training, ii) adequate provisions for systematic internal checks to prevent and detect errors and irregularities in the financial transactions, and iii) effective internal audit function and follow up. These changes have not yet been fully completed and significant further effort is required. This CFAA report provides the following additional recommendations for consideration by the GoP:

- Adopt IPSAS Cash Basis of Accounting standard to improve consistency and comparability of financial reporting at all levels of government
- Accelerate PIFRA implementation timetable as a foundation for public financial management accountability. Conduct a detailed review of the records management needed for SAP roll-out and extension of the NAM to fully cover government accounts. Adjust new Charts of Accounts, simplify record keeping procedures, and reengineer business processes to align controls and fiscal reporting
- Automate bank and account reconciliation processes. Ensure full integration of computer-based accounting systems by involving NBP, SBP, CBR, CGA, and AGP. As an interim measure, strengthen the coordination role of the Fiscal Monitoring Committees in the Provinces to ensure timely reconciliations
- Resolve technical issues related to booking receipts to the wrong accounts by issuing appropriate instructions and actions for all DAOs. Agree on the path and minimum criteria to devolve selected accounting function to provinces and local governments based on objective criteria such as full proficiency to operate and maintain the computerized system
- Strengthen internal controls. Create internal audit units. Complete introduction of CFOs to assist PAOs. Convert DACs into agency audit committees with the charters typical of such committees. Perform an annual review of internal controls and resolve outstanding issues. Assign routine internal control functions, such as voucher checking to the entities themselves, where possible. Strengthen capacities of the line departments under the newly established District governments to ensure adequate internal controls
- Build staff capacity with accounting training and certification programs. Allocate to the CGA full line responsibility for the DAOs which carry out the statutory functions of the CGA. Accounting staffing requirements should be re-designed along professional specialist models.

### 3. External Auditing

#### Benchmarks

3.1 There needs to be independent scrutiny of the Government's expenditures and revenues through an effective external audit function. The International Organization of Supreme Audit Institutions (INTOSAI), a professional organization of most of the Supreme Audit Institutions around the world, has published public auditing standards which reflect a good practices consensus. The AGP is a member of INTOSAI and has adopted these standards.

3.2 The standards comprise basic postulates, general standards, field standards, and reporting standards. The basic postulates and general standards describe the qualifications of the auditors and the auditing institution so that they may carry out field and reporting tasks competently and effectively. The standards focus on the conditions assuring the mandate, independence, objectivity, competence and due care of external auditors.

3.3 The 2001 report by Lord Sharman of Redlynch on the Review of Audit and Accountability for Central Government in the UK noted principles and characteristics of the audit of public money. These principles provide a sound basis for public audit arrangements including: i) independence of public sector auditors from the organizations being audited, ii) wide scope of public audit covering financial statements, regularity (or legality), propriety, and value for money, and iii) ability of public auditors to make the results of their audits available to the public and to democratically-elected representatives.

#### Long-Term Vision

3.4 In the next ten years, Pakistan would have:

- Fully trained, effective audit work force to complete multiple types of audits
- Performance audits completed at federal and provincial levels
- Adoption of International Audit Standards
- Monitoring of implementation of decisions on key material audit observations.

#### Description of Current Accountability Arrangements

##### *Legislation*

3.5 The AGP is established as a constitutional position with coverage of the Federation, the Provinces, and any authorities established by them. Key constitutional provisions related to public audit are:

- ◆ Article 168—provides for the appointment of the Auditor General by the President. The terms and conditions of appointment will be determined by an Act of Parliament or by the Order of the President

- ◆ Article 169—provides that the Auditor General will perform audit functions and exercise powers in relation to the Accounts of the Federation and Provinces or any authority established by the Federation or Provinces
- ◆ Article 170—provides that the accounts of the Federation and Provinces will be kept in a suitable form and in accordance with principles and methods prescribed by the Auditor General
- ◆ Article 171—provides that the reports of the Auditor General will be submitted to the President or the Governors who shall cause them to be laid before the National and Provincial Assemblies, respectively.

3.6 The Auditor General's Ordinance No. XXIII of 2001 addresses the Functions, Powers, Terms, and Conditions of Service of the AG. Under the Ordinance, the tenure of the Auditor General is a fixed term of 5 years up to age 65.

### *Independence*

3.7 The AGP is appointed by the President but the Office of the AGP remains an attached department of the Ministry of Finance, part of the executive branch of Government. The status of the AGP as an attached Department of the Ministry of Finance could be perceived as compromising the Auditor General's ability to critically examine the planning, monitoring and evaluation processes associated with the Ministry of Finance's responsibilities. However the AGP has advised that such risks have not eventuated and that the office has not been limited in practice in reviewing the Ministry, in setting AGP work priorities, or in applying audit methodologies. In addition, the Auditor General cannot be removed from office except under circumstances similar to a Judge of the Supreme Court.

3.8 The AGP has the mandate to certify the annual accounts of the Federation, Provinces, districts, departmental undertakings, and other authorities and bodies established by the government. The AGP has full access to information through its constitutional position and its legislation. No issues have been reported by AGP on any limitations in this regard. The Director General of Federal Audit in Islamabad and the Provinces Directors General of District Offices carry out the federal and provincial audits on behalf of the Auditor General. The mandate of the Auditor General is broad and covers all public funds. The AGP has financial autonomy with full powers to incur expenditure within the approved budget and to restructure the department as warranted.

### *Organization*

3.9 The audit function has been made legally distinct from the accounting function by separate ordinances. The process of segregating accounting and auditing resources and staff duties has begun but significant inter-relationships will remain. Based on Article 170, the AGP has a constitutional role in issuing guidance on accounting principles, forms and methods. Under the joint leadership of the AGP and the CGA, the GoP is evaluating the IPSAS standard for accounting on a cash basis. After the New Accounting Model is fully in place public sector practices will be more closely aligned with International Accounting Standards and thus reduce the need for the AGP to develop separate accounting principles, forms and methods.

3.10 The AGP's involvement also extends to preparation of manuals including the recently notified Local Government Accounting Manual as specified in the Local Government Ordinance, August 2001. Expeditious release and full implementation of the manual is key to building effective accountability frameworks at all levels of government

3.11 In terms of Human Resource Management (HRM), at present, the AGP administers the entire PA&AS cadre and about 2,700 audit staff. At this stage, this arrangement of a common accounting and auditing cadre has the advantage of enabling broad staff development in foundation levels of accounting. A report on human resources in the AGP from October 2002 found that there is a shortage of external audit staff with adequate skills especially in certification audits. Given the wide range of responsibilities of the AGP, substantial revision and modernization is needed in staff recruitment, assignment, training, and advancement practices. A Deputy Auditor General (HRM & TRG) has recently been appointed to a newly-created post. Consultants have prepared a Training Needs Assessment and a Comprehensive Training Plan that will address major training issues. The CTP also provides an institutional framework for training.

3.12 To begin to meet these needs, AGP has staff participating in secondments and fellowship programs in a number of developing country Supreme Audit Institutions, in internationally sponsored short courses and workshops including those organized by the Asian Organization of Supreme Audit Institutions and in AGP-sponsored degree programs at local and international universities. The comprehensive training program being developed under PIFRA will provide a path forward in addition to the CIPFA (UK) proposal for certified training. The local Pakistan Institute of Public Financial Accountants (PIPFA) is also useful for training middle level accountants.

3.13 Officers from the PA&AS cadre are selected to fill sanctioned posts based on skills, location, seniority, and other factors. There is currently a restriction on auditors being transferred to any accounting post that might pose a conflict of interest. It is essential that sanctioned positions for all audit and accounting posts be filled by competent staff. This can be part of a broader civil service reform effort.

3.14 There are substantial budget pressures on the AGP as evidenced by a lack of basic infrastructure leading to poor working conditions and the need for auditors to seek assistance from auditees for routine services like transport. Better management of available resources is needed but the overall budget may be insufficient. PIFRA-2 is expected to meet the resource shortfall to a great extent. GoP has also however shown commitment and provided substantial funds for the newly created District Audit Infrastructure.

#### *Audit Methodology and Reporting*

3.15 Currently, the AGP's methodology for certification audit is limited due to lack of an effective internal control mechanism operating in line ministries and attached departments. In the past, in many cases, audits were focused on transaction verification for selected months versus overall financial statement accuracy and completeness, and the effectiveness of internal controls. There is a need for an improved audit methodology for the range of audits included in the AGP work program. Until recently, the AGP had been using a audit manual based on the 1988 UK Public Audit Manual. A migration from transaction-based auditing to systems-based auditing is now underway under PIFRA including development of a modern Financial Audit Manual, under review by the AGP. Until the audit methodologies are updated and fully implemented, external audit effectiveness will be below its potential

3.16 Where possible, and as the new audit model takes effect, the AGP should begin to apply standard formats under the International Standards on Auditing to the audit opinion on financial statements so that the terms and implications of the qualifications are clearly expressed and understood.

3.17 In the past, the audit reports have not always recorded the auditees' commitment to take timely remedial action. Instructions have now been issued that all forthcoming audit reports must include the status of earlier audit observations and record the impact of the findings on the entity. In addition to the quality of audit reports, the timeliness is expected to be improved after PIFRA is in full operation.

3.18 The requirement to audit local level annual accounts is yet to be fully addressed. In May 2003, the 2001-2002 accounts for the local level as well as for the districts and the provinces were still in preparation or under audit. The role of the Local Fund Audit units involved in auditing local level expenditures and accounts requires clarification. To date, local government bodies have not been independently audited by AGP; they have been audited by Auditors of the Local Fund Directorate of the Provincial Finance Departments. The Local Government Ordinance provides for local bodies to be brought under control of the Auditor General. There is an alternative proposition for these units to be given an internal audit role. As both external audit and internal audit services are needed either organizational approach is satisfactory provided that suitable arrangements are made for the remaining function. In either case, there needs to be a strengthening of capacity at the local level.

#### *Oversight Arrangements*

3.19 Prior to the suspension of the national and provincial assemblies in October 1999, there had been significant backlogs in the review of audit reports by the PACs. *Ad hoc* PACs dealt with a portion of the backlog. The Federal PAC has now been established but has yet to become functional. The most recent Federal *ad hoc* PAC carrying out its oversight function at the end of 2001 found it difficult to cope with the variety and volume of audit observations and deferred performance audit reports. About 40% of audit observations had already been resolved by the PAOs. Of the remaining 60% of audit observations that were examined by the PAC, only 40% of those were resolved. The others were left unresolved for the moment. In response, the AGP has improved his audit reporting to include a strong basis for each recommendation and improvement in controls.

3.20 In respect of the oversight of the AGP, arrangements with supreme audit institutions in other countries and potentially peer reviews can be helpful in evaluating reform programs and effective procedures and implementations.

### **Recommendations**

3.21 There are substantial reforms underway that can be built upon with the support of the current reform-oriented senior management in the Office of the AGP. Greater audit focus is needed on policy issues and performance audits. Increased specialization is also required with a shift in audit focus toward certification and systems-based audits. Recommended actions are:

- Implement major audit staff training and certification programs building upon PIFRA and PIFRA 2 and taking advantage of available training institutes, PIPFA, and CIPFA. In the longer term, the AGP needs a smaller but more qualified workforce and new talent at expert functions (as per the CBR example) and a suitable merit-based staff upgradation process under civil service reform
- Improve the methodology and scope for national, provincial, and district audits through prompt and full adoption of the revised Financial Audit Manual (FAM) developed under PIFRA. This will provide a transition path for adoption of an audit methodology suitable for the New Accounting Model now being piloted
- Continue with AGP's actions to improve audit reports to focus on key issues, significant irregularities, specific priorities, actions to be taken, and effective follow up. Begin to apply standard formats based on International Standards on Auditing to the audit opinion on

financial statements when possible so that qualifications are clearly expressed. Align audit independence arrangements with INTOSAI practices

- Continue to refine the process to resolve with the PAOs many more of the audit issues before they reach the PAC examination stage. Ensure that the observations are sufficiently sound for the PAC hearings to resolve them
- Evaluate the *ad hoc* PAC recommendation from January 2001 that the AGP conduct or supervise audits in all PEs and that reports on these audits should be submitted for review by the PAC in line with the general rule that all public monies are subject to public audit by the supreme audit institution. When sufficient capacity is developed, explore the possibility of amending the Companies Ordinance 1984 to incorporate provisions regarding audit of State Owned Enterprises by the AGP or under AGP's stewardship.
- Present AGP reports to the President on an as-available basis rather than once per year.

## 4. LEGISLATIVE SCRUTINY OF PUBLIC FUNDS

### Benchmarks

4.1 Timely and well-informed legislative oversight of the manner in which the executive manages public funds is an internationally accepted good governance practice. INTOSAI standards prescribe that ministries and autonomous public bodies, regardless of the manner in which they are constituted, their functions, degree of autonomy or funding arrangements should be ultimately accountable to the supreme law making body. This accountability is enforced on the basis of reports of the Supreme Audit Institution. The standards further suggest that public access to proceedings and findings of the committees charged by the legislature with oversight functions promotes accountability and effective follow up by the executive on audit observations and recommendations.

### Long Term Vision

4.2 In the next ten years, Pakistan would have:

- Timely review of all significant audit reports by continuously active PACs with no backlogs of pending audit reports
- Adequate public disclosure of Federal and Provincial PAC proceedings and findings
- Timely action on material observations and PAC decisions, observations, and recommendations
- Fully trained, effective PAC Secretariats to support their respective PAC staff at the Federal, Provincial, and District levels.

### Description of Recent Past and Current Accountability Arrangements

4.3 PACs of the National and Provincial Assemblies are established under the Rules of Business of the respective assemblies which follow a consistent pattern in laying down the terms of reference of the committees. Generally the mandates of the PACs are quite comprehensive. In the absence of the National and Provincial Assemblies, ad hoc PACs were established by notification in August 2000 and continued functioning until the announcement of the last elections. Early activation of the committees under the Rules of Business can revive the process of legislative oversight

### Key Issues

#### Adequacy of Powers and Resources

4.4 In the case of the National Assembly of Pakistan, Rules 183-186 of Rules of Procedures and conduct prescribe the specific terms of reference of the committee. These specific provision are supplemented by general provision about the functioning of the committees defined in the Rules.

4.5 The key functions of PACs are linked to the review of the Auditor General of Pakistan's reports, both at the federal and provincial levels. The core issue therefore is how comprehensively does the mandate of the Auditor General cover spending and operations of federal, provincial, and district governments. The broader the charter of the Auditor General, the less constrained the legislative and PAC reviews. The other key aspect is how adequately does the PAC cover the issues emerging from the reports of the Auditor General. Working with AGP officers to assist PACs is a useful practice to help reduce the backlogs.

#### *Continuation of Legislative Oversight Process*

4.6 Whenever PACs have been functioning, they have contributed significantly to the overall accountability framework in Pakistan. Enforcement of the oversight responsibilities of the PACs will enhance the governance successes in Pakistan. Federal and Provincial PACs across Pakistan have not functioned on several occasions for extended periods of time and this has often created a backlog of unattended accounts and audit reports. The backlog of reports yet to be examined is listed in Table 4.1 below.

**Table 4.1: Reports Outstanding**

<i>Jurisdiction</i>	<i>Reports Outstanding</i>
Federal PAC	Reports 1989-90 to 1995-96; 1997-98, 2000-01
Punjab PAC	Reports for the years 1998-99 to 2000-01
Sindh PAC	Reports for the years 1983-84 to 1991-92; 1993-94 to 1997-98; 2000-01 Accounts for the years 1982-83 to 1991-92; 1993-94 to 1997-98; 2000-01
Balochistan PAC	Reports for the years 1990-91 to 1996-97; 2000-01 Accounts for the years 1990-91 to 1996-97; 2000-01
NWFP PAC	Reports for 1986-87 to 1988-89; 1990-91, 1992-94, 1996-97 to 2000-01 Accounts for 1986-87 to 1988-89; 1990-91, 1992-94, 1995-97, 1998-99 to 2000-01

4.7 Under the existing process, the PACs review all paragraphs in the audit reports. There are presently more than 9,000 paragraphs going back several years pending review. The implication is that many of these items are now outdated and accountability will be difficult to establish for past events. The workload of the PAC has become unmanageable and there is a need to develop a strategy to cope with the backlog. Departmental Accounts Committees chaired by the Principal Accounts Officers should proactively consider all pending reports so that the workload of the PAC is reduced.

4.8 The Auditor General is also seeking to implement a strategy to strengthen internal controls through appointment of Chief Financial Officers so that most routine accountability issues are addressed through a credible process of internal accountability and the Auditor General's organization can focus on significant issues.

4.9 The performance of the last *ad hoc* PAC was successful in providing continuity to the accountability process. In an effort to cope with the arrears, the federal committee formulated a hectic agenda and worked for two weeks each month. The committee completed the review of the audit report on the accounts of 1999-2000 but the arrears position was not significantly reduced. The risks arising from lack of continuity in the past still need to be managed through a proper strategy that may actively involve the PAC secretariats.

4.10 Because audit reports cover a very wide range of subjects, the PACs require adequate support from their Secretariats to process and organize the work at hand. The Secretariat of the Federal PAC is adequately resourced. The capacity of the Secretariats of Provincial PACs could be reviewed and augmented where required.

4.11 The capacity of the PAC Secretariat of the National Assembly may also require augmentation depending upon what strategy is adopted by the PAC to eliminate arrears of previous audit reports. The Office of the Auditor General could also be involved in this effort. PAC Secretariats provide some continuity to the process even in the absence of the PACs, as they can and do follow-up on outstanding reports under consideration of the committee.

4.12 The issues of adequate attention to PAC meetings, the transparency of the PAC proceedings, and the capacity to hold effective committee deliberations are fundamental to improving public financial accountability. Demonstration of the Executive's commitment to take timely remedial action in response to PAC review and implementation of decisions is critical to the success of the overall accountability process. This crucial loop has not been without risks in the past and the risks have been increased by continued non-consideration of audit reports and non-functioning of legislative oversight for prolonged periods.

#### *Improving transparency of PAC Reports and follow-up*

4.13 While Public scrutiny of the government's activities, revenue, and expenditures is diluted due to lack of timely review of accounts and audit reports by PACs, openly conducted legislative oversight has the effect of enhancing the value of public scrutiny. This was demonstrated when the proceedings of the *ad hoc* PACs set up under executive order were opened to the public and press. This has also created a public awareness and increased expectations.

4.14 The PACs of the elected assemblies will have to take their decision under the respective rules of business. When proceedings are closed, the public is often not sufficiently informed on the rigor with which scrutiny of the public purse is carried out by the legislatures, nor on the commitment of the executive to take remedial action in response to audit observations. Best practices require that in order to remain effective as accountability institutions, PACs should function on an apolitical basis to decide issues on merit and substance, which may become difficult when proceedings are made public. Whether the proceedings themselves are held publicly or not, the findings of the PAC do become public when committee reports are tabled in the assembly. There is a need to generate open debate in the Assembly on PAC reports and findings.

4.15 There is little information on government follow up on PAC reports and on enforcement of corrective actions and disciplinary processes following PAC reports. The PACs need to monitor remedial activities related to their findings, decisions, and recommendations. The Finance Division and Departments can play a crucial role in coordinating with the AGP, PAC Secretariats, and departments to prompt early implementation of the findings, decisions, and recommendations of the PACs.

#### *Increasing Capacity of PACs*

4.16 There is a trend toward establishing regional and international associations of PACs and efforts are underway in the South Asia region for formation of such an association. The PAC members could also benefit from direct exposure to the work of PACs in other countries. National and international associations of legislative review committees (e.g., Canadian Council of Public Accounts Committees,

Australasian Council of Public Accounts Committees) have formulated policy guidelines which may be used for reference by other PACs.

4.17 A trend is also emerging for identifying best practices of legislative oversight. In addition, Annex 4 contains a partial listing of sample procedural rules and guidelines for PACs based on good practices in improving accountability from the Canadian Council of Public Accounts Committees.

## Recommendations

4.17 Recommended actions in legislative scrutiny are:

- Form and convene pending Federal and Provincial parliamentary PACs to provide effective oversight
- Encourage and support PACs and their Secretariats to devise strategies to clear respective backlogs of audit reports in Federal and Provincial PACs having backlogs. Select key reports or issues for maximum benefit and impact
- Discuss PAC findings in Plenary session of the National Assembly. Consider steps to widely discuss PAC findings and table formal responses on actions taken in the assemblies. Consider the experience of open proceedings to the press and public based on the practices of the *ad hoc* PAC and adopt a strategy consistent with the Rules
- Provide support to newly-formed local government District Accounts Committees
- Activate DACs to consider audit reports and finalized actions where possible. PAC Secretariat may also follow up with executive to prompt action on audit reports so that the latest position is available to PACs when they take up audit reports for consideration.

## 5. ACTION PLAN MATRIX

Based on the recommendations presented in each of the preceding sections, a comprehensive action plan has been prepared to consolidate them into a format that is easy for the GoP to track.

<i>Domain</i>	<i>Actions</i>	<i>Agency</i>
<b>Budget Development and Execution</b>	Clarify fiscal framework and resource allocation among three tiers of government	MoF, Provinces, 2004
	Refine and publish budget manual with common procedures and formats under NAM for three tiers of government	MoF, Provinces, 2005
	Disclose contingent and long-term liabilities, and debt	MoF, 2005 Provinces, 2006
	Strengthen the role and powers of the FMC	MoF, 2004
	Train staff in line ministries in budget execution	MoF, Line Ministries, PC, 2005
	Delegate budget preparation and re-appropriation to local government	MoF, 2005
	Ensure that all budget components are paid directly to each local government in accordance with the Award.	MoF, 2004
<b>Accounting and Reporting</b>	Adopt IPSAS Cash Basis of Accounting Standard. Draft action plan for adoption. Agree on action plan	AGP, CGA 2005
	Accelerate PIFRA I implementation by increasing support and management commitment	AGP, CGA, 2004
	Expand rollout under PIFRA 2 and evaluate and implement extensions for budget development functionality	CGA, 2005
	Improve bank and account reconciliation process	AGP, CGA 2004
	Automate reconciliation process	CGA, 2005
	Implement devolution directives as relating to accounting and auditing matters while building infrastructure and capacity	AGP, CGA, 2005
	Develop a strong internal control framework at all levels of government, including districts and tehsils	CGA and AGP, 2005
	Improve pre-audit, implement expenditure certification, and conduct compliance checks	CGA, AGP, FDs, 2004
	Resolve the administrative control in respect of the AGs in accordance with the law	AGP, CGA, FDs, 2005

<i>Domain</i>	<i>Actions</i>	<i>Agency</i>
	Build staff capacity with major accounting training and certification program.	CGA, GoP, Provinces 2004
<b>External Audit</b>	Implement major audit staff training and certification program	AGP, 2004
	Improve audit methodology and scope through FAM	AGP, 2004
	Implement upgraded audit methodologies and report formats	AGP, 2005
	Establish liaison with CGA on financial attest linkage to internal control structure	AGP, CGA, MoF, 2004
	Implement internal control structure in line Ministries and Departments	AGP, CGA, 2004
	Strengthen institution of CFO	MoF, 2004
	Begin to apply standard audit formats based on IAS	AGP, 2004
	Align audit independence arrangements with INTOSAI practices	AGP, 2005
	Continue to resolve more audit issues with PAOs	AGP, PAOs, 2004
	Evaluate <i>ad hoc</i> PAC recommendation to supervise PE audits	MoF, AGP, 2004
	Present AG reports to President/Governors as they become available	AGP, 2004
<b>Legislative Scrutiny</b>	Form and convene Federal and Provincial PACs	Parliament, 2004
	Have PAC Secretariat staff follow up with executive departments to obtain responses on pending audit reports	PAC Secretariat, 2004
	Issue instructions to PAOs to activate DACs and prepare departmental response to pending audit reports. Provide required support to DACs	MoF, 2004
	Use DACs to take action on outstanding reports	Executive depts, 2004
	Develop strategy to focus PACs on recent and subsequent reports	PACs, 2004
	Develop greater awareness among PAC members and staff about practices of legislative accountability	PAC and Secretariat, 2004
	Develop position papers to brief PACs	PAC Secretariat, 2004
	Discuss PAC findings in Plenary Session of the National Assembly	National Assembly, 2004
	Table formal action reports before the PAC	MoF, other Ministries and Departments, 2004

## **List of Technical Annexes**

Annex 1 Government Reforms

Annex 2 Public Expenditure Management Under Devolution

Annex 3 Accounting in Public Enterprises

Annex 4 Sample Rules for Public Accounts Committees

## ANNEX 1. GOVERNMENT REFORMS

The Federal reforms conducted so far are listed below.

### *Major Structural Reforms*

Tax Reform	<ul style="list-style-type: none"> <li>• Tax survey and documentation exercise undertaken.</li> <li>• Wealth tax abolished.</li> <li>• A two-tier agricultural income tax introduced.</li> <li>• Reduction in number of taxes (Federal and Provincial), tax rates, and penalties.</li> <li>• Tax ombudsman's office established.</li> <li>• Grass roots reforms in tax administration started.</li> <li>• Goods and Services Tax adopted, broadened, and streamlined.</li> <li>• A new Income Tax Ordinance on universal self assessment basis with selected audit, minimal exemptions, and more equitable rates have been introduced.</li> <li>• Large taxpayer unit has been established.</li> <li>• Fiscal Responsibility Law is expected to be put in place shortly.</li> </ul>
Trade Reform	<ul style="list-style-type: none"> <li>• Public announcement of tariff rationalization, spread over 2001-03:</li> <li>• Maximum tariff brought down to 25 percent.</li> <li>• Number of tariff categories reduced from five to four.</li> <li>• Minimizing the use of excise duties in tariffs.</li> <li>• Promulgation of anti-dumping law consistent with WTO.</li> <li>• Import liberalization measures adopted for agricultural and petroleum products.</li> <li>• Restrictions on agriculture exports removed.</li> </ul>
Deregulation and Privatization Reform	<ul style="list-style-type: none"> <li>• Privatization law enacted. Major privatization deals considered (PTCL, banks, oil and gas interests).</li> <li>• Petroleum price adjustment mechanism introduced</li> <li>• Furnace oil excluded from freight pool.</li> <li>• LPG price deregulated.</li> <li>• Oil and Gas Regulatory Authority established.</li> <li>• NEPRA is operational to regulate power sector.</li> </ul>

---

***Major Structural Reforms***

---

Financial Reform	<ul style="list-style-type: none"> <li>• Profit rates on NSS certificates rationalized.</li> <li>• SBP strengthened, regulatory role improved.</li> <li>• Non-core activities of SBP have been separated from its core monetary function.</li> <li>• CIRC established for non-performing loans.</li> <li>• Change in managements in NCBs with focus on professionalism and autonomy in operations.</li> <li>• Banking companies ordinance amended to enforce capital adequacy ratios in line with international standards.</li> <li>• SEC strengthened and insurance sector deregulated.</li> </ul>
<hr/>	
Governance Reform	<ul style="list-style-type: none"> <li>• Restructuring and rightsizing of civil services.</li> <li>• Proposals for rationalization of pay and pensions being finalized.</li> <li>• Increased autonomy granted to Federal Public Service Commission</li> <li>• Strong focus on training and improved procedures for performance assessment.</li> <li>• Devolution of power to grass root level.</li> <li>• Judicial reform.</li> <li>• Police reform.</li> <li>• National Anti-Corruption Strategy in place.</li> <li>• Freedom of Information Act Promulgated.</li> <li>• Pakistan Public Procurement Authority established</li> </ul>
<hr/>	
Fiscal Transparency Reform	<ul style="list-style-type: none"> <li>• Separation of audit and accounts: legislative measures adopted.</li> <li>• Formation of <i>ad hoc</i> Public Accounts Committees at federal and provincial level.</li> <li>• Establishment of “new system of financial controls and budgeting.”</li> <li>• Publication of fiscal reports verified by the AGPR.</li> <li>• Fiscal reform unit established.</li> </ul>
<hr/>	
Human Development and Social Protection Reform	<ul style="list-style-type: none"> <li>• Khushal Pakistan Program launched.</li> <li>• Education sector reforms.</li> <li>• Improvement in health sector delivery system.</li> <li>• Zakat and ushr system revamped</li> <li>• Establishment of Khushali Bank</li> <li>• Food support program for 1.2 million poorest households.</li> </ul>

---

<i>Outcome</i>	<i>Performance Benchmark</i>
<i>The Sindh Reform Program has the following governance elements.</i>	
<ul style="list-style-type: none"> <li>• More reliable, comprehensive, timely and accurate information pertaining to the government financial transactions.</li> <li>• Improved internal control environment.</li> <li>• Increased credibility of government financial statements with public and the international donor community.</li> </ul>	<ul style="list-style-type: none"> <li>• Progressively improved reconciled data in all accounting units.</li> <li>• Substantial reduction in “unidentified” financing from public accounts and deposits.</li> <li>• Up gradation of the grade levels of DAOs and TAOs (Grade 18/19).</li> <li>• Significant increase in the number of DAOs posted in the revised upper grade with appropriate qualifications and experience approved by the CGA.</li> <li>• Progressively increasing percentage of government transactions processed through computerized accounting.</li> <li>• Establishment of an effective internal audit unit for each Ministry and Department.</li> </ul>
<ul style="list-style-type: none"> <li>• Improvement in financial management of provincial and local governments.</li> </ul>	<ul style="list-style-type: none"> <li>• Appointment of a Provincial Financial Controller</li> <li>• Constitution of a Coordination Committee</li> <li>• Carry out a provincial financial accountability assessment and agree on a detailed time bound improvement program.</li> <li>• Publication of financial reports (half yearly from FY2004 and quarterly from FY2005) along with annual audited financial statements of District Governments.</li> </ul>
<ul style="list-style-type: none"> <li>• Increased deterrence to fraud, waste and abuse of public funds and investment.</li> <li>• More open, productive and answerable government.</li> <li>• Increased credibility of government audited financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• Incorporation of details of actual cash recovery from audit findings due to fraud, waste and abuse reported in the Auditor General’s annual report.</li> <li>• Auditor General’s recommendation accepted by the provincial PAC to be tracked through a Management Information System (MIS).</li> <li>• Percentage of PAC’s recommendations accepted by the Government for implementation to be tracked through an MIS.</li> <li>• Posting of audit reports in the web page soon after PAC discussions</li> </ul>
<ul style="list-style-type: none"> <li>• Improvement in public procurement</li> </ul>	<ul style="list-style-type: none"> <li>• Improvement in the legal and regulatory framework for public procurement by revising procurement rules and manuals, standardizing bidding documents, and establishing an effective mechanism to redress complaints from suppliers and contractors. New procurement law legislating good public procurement practices.</li> </ul>

<i>Outcome</i>	<i>Performance Benchmark</i>
<i>The NWFP Reform Program has the following governance elements.</i>	
<ul style="list-style-type: none"> <li>• More reliable, comprehensive, timely and accurate information pertaining to provincial and district government financial transactions</li> <li>• Improved internal control environment</li> <li>• Increased credibility of provincial and local government financial statements with public and international donor community</li> </ul>	<ul style="list-style-type: none"> <li>• Progressively improved reconciled data in all accounting units.</li> <li>• Substantial reduction in “unidentified” financing from public accounts and deposits.</li> <li>• Progressive closure of all off-budget accounts.</li> <li>• Up gradation of the grade levels of DAOs and TAOs (Grade 18/19).</li> <li>• Improving quality of the staff of DAOs through training and fresh induction.</li> <li>• Progressively increasing percentage of government transactions processed through computerized accounting (SAP).</li> <li>• Publish useable budget monitoring reports</li> <li>• Establishment of an effective internal audit unit for each Ministry.</li> <li>• Publishing audited accounts of PEs, autonomous and quasi-autonomous bodies.</li> </ul>
<ul style="list-style-type: none"> <li>• Improved financial management of all levels of NWFP government</li> </ul>	<ul style="list-style-type: none"> <li>• Appointment of Provincial Financial Controller</li> <li>• Operationalization of PAC</li> <li>• Constitution of Task Force/Steering Committee</li> <li>• Carry out a provincial financial accountability assessment and agree on a detailed time bound FM improvement program</li> <li>• Publication of annual reports (half-yearly from FY 04 and quarterly from 05) along with audited financial statements of district governments.</li> </ul>
<ul style="list-style-type: none"> <li>• Improved external audit and legislative oversight</li> <li>• More open and answerable government</li> </ul>	<ul style="list-style-type: none"> <li>• Incorporation of details of actual cash recovery from audit findings due to fraud, waste and abuse reported in the Auditor General’s annual report (installation of tracking system for recoveries on account of audit findings).</li> <li>• MIS to determine % of audit recommendations accepted by the PAC</li> <li>• MIS to review % of PAC’s recommendations accepted by the Government.</li> <li>• Posting of audit reports in the web page soon after PAC’s discussion</li> <li>• Prescribing a schedule of examination of audit reports by PAC, by amending the Standing Procedure</li> <li>• Making PACs open to media</li> </ul>
<ul style="list-style-type: none"> <li>• Improvement in Public Procurement</li> </ul>	<ul style="list-style-type: none"> <li>• Enact Procurement Ordinance</li> <li>• Develop and notify new Procurement Rules and Regulations.</li> <li>• Develop and adopt standard bidding documents.</li> <li>• Initiate institutionalized procurement training programs for government staff</li> <li>• Establish effective mechanism to redress complaints/grievances from suppliers</li> </ul>

## ANNEX 2. PUBLIC EXPENDITURE MANAGEMENT UNDER DEVOLUTION

### Public Expenditure Responsibilities<sup>2</sup>

Regarding the distribution of government responsibilities, the 1973 Constitution delineates the expenditure responsibilities of Federal government (Federal Legislative List) and the areas of shared responsibilities (Concurrent Legislative List). All residual functions are the domain of provincial governments. Local governments functions are defined under provincial laws through the use of Local Government Ordinances (LGOs). According to the Constitution, the Federal government is responsible for such key areas as defense, foreign affairs, banking and currency, postal service, transportation (ports, airports, railways), international trade, macroeconomic management and industrial development. The provinces share with the Federal government responsibility for population planning, irrigation, curriculum and syllabus planning, and social welfare. Provinces are solely responsible for roads, highways, law enforcement (police) and dispensation (justice), education and health.

Under the LGOs 2001, the provincial governments have devolved a large portion of their responsibilities to the local (district, tehsil and union) governments. Table A2-1 presents selected areas of responsibility for each level of local government.

**Table A2.1: Selected Expenditure Responsibilities of Districts, Tehsils and Union Councils 2002**

<i>Responsibility</i>	<i>District</i>	<i>Tehsil</i>	<i>Union Council</i>
Education	Primary and secondary education, Literacy	X	X
Health	Dispensaries and local hospitals	X	X
Roads	District roads	Local roads and street	Local streets
Water	City Districts	Water supply systems	Wells and Ponds
Sewers and Sanitation	X	Yes	X
Fire services	X	Yes	X
Parks playgrounds	X	Yes	Yes
Animals	X	Slaughterhouses, Fairs	Cattle pounds and grazing areas
Cultural and sport services	X	Fairs, cultural events	Libraries
Street services	X	Street lighting signals	Street lighting
Miscellaneous	X		Register births and deaths

Note: an X indicates no direct spending responsibility

There is, however, significant scope for devolving functions from the Federal to the provincial governments.

<sup>2</sup> World Bank PER, 2003.

### **Public Expenditure Management under Devolution<sup>3</sup>**

Decentralization reform has been brought into effect through amendments such as in the Sindh Local Government Ordinance 2001. These have replaced the earlier transition arrangements providing the basic design of the framework of local government finance as well as intergovernmental fiscal relationships. The amendments mainly comprise the new Chapters XII and XII A in the Ordinance. According to these amendments the following significant changes have been brought in:

- Local funds and provincial accounts have been merged. The effect of these mergers is different for District Governments and the Tehsil Municipal Administrations (TMAs). For the former, on merger, a District Fund has been created. For the latter, a Taluka/Tehsil/Town Local Fund has been created.
- The basic principles of budgeting have also been prescribed. The details of the process will come in through a set of rules on the subject. The budget code has been notified in Sindh and the positions of the other provinces have been updated. These have been alluded to in Schedule Five to the Ordinance. The set of rules exists in draft form and local government personnel have been trained on their application starting with the next budgetary process.
- The local governments at all levels have large revenue gaps and these are being met from intergovernmental transfers in accordance with an Interim Financial Award given by the Provincial Finance Commission. Therefore intergovernmental fiscal transfers are of critical significance for stable local fiscal environment. These are more critical for district governments who do not have any sustained source of revenue so far. The TMAs are also dependent on transfers, especially of the replacement grants of Octroi & Zila Tax, for running their affairs. The manner of calculation of the allocable amounts, timeliness of transfers and local level fungibility are the various important aspects of these sources of revenue for local level decision making.
- Capacity of the local government to operate expenditure management systems is a function of the provincial civil servants at their disposal as well as the autonomy that they have for hiring experts from the market.
- For the district governments the District Accounts Offices have been mandated to prepare accounts under the administrative control of the Accountant General. Auditor General will carry out the post audit of the accounts. For the TMAs and Union Administrations, the Local Fund Audit department will continue to perform these functions until such time that the AGP develop capacity to audit them.

#### *Important Mechanisms*

Budget Code has been promulgated for the local governments. Instructions have been issued by the Planning & Development Department for processing, appraisal and approval of development projects. A detailed Budget Code exists in draft form and local government finance personnel have been trained on its use. It will require notification by the Provincial Government to make it operational in accordance with the Fifth Schedule to the Sindh Local Government Ordinance 2001.

---

<sup>3</sup> Extract from Devolution and Service Delivery in Pakistan Project, 2003

Account IV has been provided for District Funds (for Taluka and Union Local Funds details of the arrangement to be confirmed). The monies are transferred to the respective Funds, from Account I to Account IV, on a cash basis. Operation of Account IV is improving during the transition.

District Accounts Officers have been authorized to maintain accounts of the District Governments. They are using the Chart of Classification applicable to the Province in accordance with the four Volume Accounts Code applicable to the Province. Draft Accounts Code has been used for training of accounts personnel but it has not been notified for the District Governments. For the TMAs the earlier instruments of local government remain applicable setting accounting norms and standards as well as the classification. The audit responsibilities for the TMAs, however, lies with the AGP.

#### *Equalization and objectives of transfers*

The fiscal transfer formula which has been brought into effect through the interim Provincial Finance Award lays out the manner of calculation of shares of local governments. It has an elaborate formula for the district level but a simpler one for calculating shares of TMAs and Union Administrations. The latter are under consideration for revision as well. The main features of the formula are:

- A Provincial Divisible Pool has been created to include three types of revenues of the Province: Federal tax assignments, provincial tax receipts, straight transfers. Provincial non-tax receipts are not included. Similarly, the IDA credit received as a budgetary support remains outside the pool. The donor funds received by the province are also not allocable through the divisible pool.
- Forty percent of the divisible pool has been assigned as the Provincial Allocable at primary distribution for meeting the recurrent expenditures of the local governments (the earlier local council staff and local financing of the TMAs is not included in this expenditure benchmark). The formula for the secondary distribution is based on calculated shares in which population has a weighting of 50% whilst the others are backwardness 17.5%, tax collection 7.5% and transition transfer 25% (presumably the TMAs' provincial establishments are included in the districts for this calculation).
- A provincial development divisible pool is part of the Award to finance capital grants to local governments. A fixed size of Rs.7000 million has been estimated for the annual development outlay. From this Rs.1200 million for counterpart funds of foreign assisted provincial portfolio and another Rs.290 million for compensatory allocation to District Governments with lower allocation from the formula have been subtracted to create a divisible pool of Rs.5510 million. A formula is applied for the secondary distribution among the district governments which gives a weighting of 50% to population, 30% to backwardness whilst 10% of the total district share will be used for ongoing schemes and 10% will be divided equally amongst the districts.
- The third grant created by the Provincial Finance Commission (PFC) is for transfer of amounts receivable on account of 2.5% additionality of GST. It is comprised of three components: the first, Rs.6500 million, will be distributed among districts in accordance with the baseline shares—proportions in the total amount collected in 1998-99; the second, Rs.2800 million, will be distributed through a formula which gives weightings to population (70%) and backwardness (30%); and the third, the remaining funds in the total receipts, will be given in accordance with the backwardness index.
- The award itself does not clearly specify the sharing arrangements for TMAs and Union Administrations from the District Government. The arrangements applicable last year remain in force whereby TMAs will get the share from the replacement grant in accordance with their final

collections of Octroi whilst the UAs will get equal shares from the district share. In case of the latter it comes from 25% of the district share of the final collection of the Zila Tax received by the District Government whilst 75% is retained by the District Government. PFC is deliberating on the proposals of the Local Government Department for establishing new sharing arrangements.

The main objective of the transfers is revenue adequacy for the local governments. This overrides other concerns for providing shares for equalizing for fiscal needs. This is mainly for meeting recurrent expenditure needs. The capital grants aim for equalization for needs through calculation of shares for proxies of fiscal need. These are population with a weight of 50% and backwardness with a weight of 30%. In addition, completion of ongoing schemes has been retained as another objective. For this purpose 10% of the funds earmarked for capital grants are apportioned among the districts based on assessment of the absorption capacity of individual projects as well as the desirability to continue.

From the local governments' perspective the formula can institute predictability as well as assurance of non-partisanship in apportionment of the provincial funds. This is largely achievable on application of the interim formula. Calculation of backwardness index and allocation of resources on that basis raises two further issues. One, the validity of the indicators and sources of data used for it will require enquiry. If they are acceptable then their alignment with need may be a valid assumption. Second, the detailed analysis of the indicators will be required to see if they are actionable in the short to medium term to produce sufficient incentives for the local political executive to make appropriate policy choices. Conditional grants are provided from the provincial retained amount.

### **Implementing the MTBF**

Given that Pakistan is a federation, it is critical for improved budgetary outcomes and enhanced effectiveness of public expenditure that MTBF process is rolled out to the provinces and then to all the districts. Ultimately, the national MTBF would be consolidation of sub-national and Federal MTBFs. It is essential that the process of promoting provincial adoption of MTBF is led by a strong commitment from the center. The MTBF is not easy to make operational in a complex and fast changing environment. With limited automation and analytical tools, it is even more difficult. But the key benefits of an effective MTBF approach are:

- Improved certainty over the level of available resources, permitting clear-cut decisions over what can and cannot be funded and hence a firm guarantee to sector departments of funds being made available in line with budgets
- Enhanced participation and ownership among line departments in the budget process as a result of its improved predictability and consistency and improved management of the overall resources available to the budget, implying both enhanced allocations to priority sectors and more efficient management of funds received
- Improved consistency between macroeconomic performance, policy formulation and public expenditure with *explicit* inclusion of all development resources (both internal and external) in the budget process
- Better defined and more detailed budget calendar, fully respected by all spending agencies and central ministries and greater transparency over budgetary allocations and procedures and increased clarity over the expected outcomes of public expenditure

- Improved quality and efficiency of service delivery by refocusing the attention of departments on the outputs and planned outcomes of expenditure
- Structured evaluation process of government projects and programs to assess the efficiency with which their programs meet original or revised policy objectives. This opens up a possibility of instituting “sunset-clauses” in the approval of projects and program, that require a program to be abandoned after a certain time period unless it can justify its continuance.

### *MTBF Process*

A typical MTBF would entail initiating a process of rigorous costing and analysis of existing policy commitments with a view to improving efficiency and developing a firm baseline cost for essential continuing services of government. Maintaining a continuous medium-term view of these elements provides an essential foundation for a full MTBF. The next step would be developing a three-year macroeconomic framework as a starting point for the MTBF using improved techniques for macroeconomic analysis and revenue forecasting—and publishing the basis for medium-term macroeconomic and revenue forecasts in the 2001/02 Budget papers.

From there, establishing an expenditure review team in the MoF with the task of reviewing all existing commitments of government (Part A of the budget) through a series of intensive studies of different sectors is warranted. The overall objective will be to establish a baseline cost for continuing essential government services. Once established, this baseline can be projected forward and published as forward estimates in the MTBF framework. Further steps involve:

- Developing broad aggregates for revenues and sectoral and subsectoral expenditure ceilings and obtain Cabinet’s approval for these ceilings.
- Making all ministries/departments responsible for extending their permanent and temporary budget forecasts by another two years and separately identifying additional costs over a three-year period
- Strengthening capacity for sectoral and expenditure policy assessments that include relevant performance information
- Making the budget for the following year in a rolling format so that in the following year’s budget, the existing policy estimate for the first year will be taken as the baseline for the Ministry in negotiating the budget. Similar procedures will be followed each year.

## ANNEX 3. ACCOUNTING IN PUBLIC ENTERPRISES

### Benchmarks

Within commercially-oriented public enterprises (PEs), indications of good financial management include: i) independence and autonomy of the management board and the accountability and competence of the management, ii) financial management and accountability rules based on clear legal foundations, iii) good budget practices including realistic forecasts, hard budget constraints, and reduced dependence on Government fiscal support, iv) use of International Accounting Standards for preparing accounts, and v) good public disclosure standards.

#### *Improving accounting in Public Enterprises*

The following weaknesses were documented in public enterprises: i) cash-based accounting systems, ii) reconciliations based on Statements of Expenditures (SOEs) rather than a cashbook, iii) SOEs and informal expense registers do not show any evidence of check, iv) inadequate segregation of accounting duties with no internal audit function and lack of independent system of internal checks, and v) inadequate training for accounts personnel.

To remedy these weaknesses, a separate internal audit function and an overarching set of internal controls for PEs is warranted. This needs to be supported by a timetable of internal checks with particular relevance to each PE to be carried out

#### *Accounting and Reporting for Public Enterprises*

Public Enterprises in Pakistan are of three types: departmental undertakings, statutory public corporations, and joint stock companies with partial public ownership. The latter two are commercially oriented. Departmental undertakings include government-owned and -managed operations such as railways and posts and telegraphs services.

Annual funding requirements of PEs defined as departmental undertakings are presented to and passed by the legislature as demands for grants. The accounts of these enterprises are audited in a manner similar to other government departments. The audit reports are placed before the Parliament and thereafter discussed by the Public Accounts Committee. These reports include an overall survey of the financial position of the undertaking and also specify any lapses on the part of the administration.

Statutory Public Corporations are created under special statutes that specify their policy guidelines. Operational decision-making is vested in the Board of Directors. A detailed scheme which includes power of the government to appoint Directors and Chief Executives on the boards of such companies and the requirement of submission of annual performance reports to the Parliament is incorporated in the charter of these companies.

These charters which include financial management forms and procedures vary from something close to the system of departmental companies (e.g., WAPDA, NHA, and CAA) to a system that more closely resembles a joint stock company. In these cases, a significant proportion (usually more than 51%) of the paid-in capital is held by the government. Accountability to the government is thus exercised through the Board of Directors of these companies, most of whom are appointed by the government. These

enterprises are expected to function as any other privately managed company and are required to conform to prevailing corporate regulations. Such enterprises enjoy substantial freedom in decision-making although government-nominated directors can exert control over decision-making and administrative Ministries can issue directives that extend to the investment as well as the operational policies of these companies. The Privatization Commission has engaged in a program of PE sales and has recently set up a committee to identify additional entities for sale.

### *Improving the Accountability of Public Enterprises*

PEs have historically incurred substantial losses. The PER (2003) found that with privatization, gains in operating efficiency, reduction in theft, and expected lower generation costs because of the increase in share of hydro power, it should be possible to reduce the losses of the main loss makers, WAPDA and KESC gradually from about Rs. 40 billion, or 1 percent of GDP in the current year, to Rs. 10-12 billion, or 0.2 percent of GDP by FY07. The government needs to ensure, however, that other public enterprises such as Pakistan Railways, Pakistan Steel, PIA, and state-owned banks do not fall back into deficit and that guarantees provided by government do not have a net cost to the budget.

Regarding PEs, the structure and accountability framework of most is still based on legislation enacted during 1972-78 such as the Economic Reforms Order (ERO), 1972 and the Development of Industries (Federal Control) Act, 1972. The ERO had given the Federal Government the power of appointing Managing Directors of the Federal PEs. The Managing Directors were to hold office during the tenure of the Federal Government and be subject to such orders and directions that the Federal Government may give from time to time. The statutes of public enterprises are based on the provisions of the Companies Ordinance 1984, Capital Issues (Continuance of Control) Act, 1947, The Companies (Managing Agency and Election of Directors) Order, 1972, and Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance, 1970.

In practice, financial management and accountability in PEs has been weak due to several reasons:

- Close involvement in the day-to-day affairs of the companies by the bureaucrats of the controlling ministries or managers of holding companies has eroded the autonomy and accountability of PE management. Having a large part of their capital expenditures funded by Public Sector Development budget has exacerbated this
- The management of the public corporations has not always been professionally staffed. The Finance Directors of the public corporations being generally appointed from the staff of Ministry of Finance are not selected on the basis of experience in the financial management of large commercial enterprises
- Weak internal financial controls within the PEs constitute a major shortcoming of their financial management system. Like the rest of the government, PE annual budgets are prepared on incremental basis without a performance orientation. Internal audits are generally viewed as unnecessary. The reasons for this vary. Internal audit has tended toward routine post-audit test checks
- The external auditors for the PEs are engaged by the management and the objectivity of external audits could be an issue. Private sector chartered accountants usually conduct external audits of PEs and the objectivity of these audits needs to be monitored
- The accountability of public corporations has been compromised by giving their management relatively broad powers compared to shareholders. Explicit provisions exist in the various

Acts and Ordinances governing PEs which curtail the rights of shareholders, in regard to general meetings and election of directors, and in relation to the appointment of auditors. The jurisdiction of courts and regulatory bodies such as Monopoly Control Authority, Securities and Exchange Authority is suspended. The law provides extensive protection to the directors

- Although the mandate of the Auditor General extends to all public funds, in practice some have been exclusively audited by private audit firms and have focused on the statutory financial statement audits. Also, not all reports on these audits have been presented to the legislature or reviewed by the Public Accounts Committees. There has been confirmation by the *ad hoc* PAC in January 2001 that the Auditor General has the mandate to conduct or supervise audits in all PEs and that reports on these audits should be submitted for review by the PAC.

## Recommendations

- Perform a critical review of the statutes of most of the PEs and the applicability of laws on corporate governance (e.g. the Companies Ordinance, the role of the Securities Exchange Commission and Monopoly Control Authority) and through them subject PEs to the same discipline as private sector companies
- Introduce efficient internal control procedures in PEs. Prepare performance-oriented budgets that include participation of managers and departments of the enterprise including marketing, operations, production, maintenance, personnel and administration, finance, accounts, and insurance. Physical targets for the year should be set after a review of the past performance, capacity, market condition and potential, and estimates of revenue and expenditure should be formulated on this basis
- Reorganize and initiate internal audit functions under professionally qualified leadership so that these could serve as effective management tools to improve internal controls and overall efficiency of the enterprises
- Enforce the requirement on PEs that their financial statements be audited and submitted to the government with their Annual Report within six months of the end of the financial year. Ensure that any financial statement audit reports on PEs carried out by private audit firms will be placed before the legislature and discussed by the Public Accounts Committee
- Introduce computerized accounting software in each PE to suit its accounting needs, including the Ministry of Railways with perpetual store records should also be computerized.

## ANNEX 4. SAMPLE RULES FOR PUBLIC ACCOUNTS COMMITTEES <sup>1</sup>

---

### POLICY GUIDELINES

---

The Public Accounts Committee should operate in a non-partisan fashion if it is to effectively conduct a rigorous scrutiny of government expenditures.

---

The role of the Public Accounts Committee is to hold the government accountable for its spending of taxpayers' money and its stewardship over public assets.

---

Public Accounts Committees should have a clear formal mandate to scrutinize the activities and operations of all government agencies and corporations in which taxpayer funds have been invested, and to scrutinize the value for money obtained through privatization of any such bodies.

---

The role of Public Accounts Committees in ensuring accountability of transfer payments needs to be defined and formally established.

---

The role of PACs in reviewing tax expenditures should be defined and formalized.

---

The Public Accounts Committee should not concern itself with the policies of government; it should be concerned with ensuring that the policies and government are implemented in an effective, efficient and economical manner and that there is value for monies spent.

---

Public Accounts Committees should hold public servants accountable for their performance of the administrative duties and implementation activities that have been delegated to them.

---

The Public Accounts Committee shall strive to ensure that there is a procedure in place to have a new Public Accounts Committee appointed shortly after the commencement of the first session of each Parliament.

---

The Public Accounts Committee shall strive to ensure it obtains resources required to efficiently fulfill its role and responsibilities in an effective manner.

---

The Public Accounts Committee should be required to report to the Legislature annually, have the report debated in the House, and have the right to request government to table a comprehensive response to the Committee's report within 120 days.

---

The Public Accounts Committee should have the right of access to all financial information and other documents as it determines necessary for its investigations, except for those that are privileged in the narrowest sense of the law such as Cabinet documents.

---

---

**PROCEDURAL GUIDELINES**

---

Each Public Accounts Committee should adopt a statement that describes the committee's role and responsibilities and comprises a general statement of purpose and a list of issues that the committee is to examine, assess, report on to the legislature, and follow-up with the administration.

There should be referral of both the public account and the auditor's report as soon as they become available.

Provision should be made to allow Public Accounts Committees to meet whether the legislature is in session, or not.

Chairmen should play a leading role in all aspects of committee work and participate in the questioning of witnesses and in other committee deliberations.

PACs should appoint a steering committee to plan the work and to bring forward drafts of committee reports.

One clerk, who gives first priority to these duties, should be assigned to serve each Public Accounts Committee.

Research assistance should be provided to Public Accounts Committees.

Compensation should be made to members of Public Accounts Committees for their attendance and participation at meetings.

All Public Accounts Committee findings should be open to the public except in matters of a particularly sensitive nature.

Committees should keep brief, formal minutes of proceedings.

Public Accounts Committees should schedule sufficient, regular meetings to discharge their responsibilities.

Procedures for questioning witnesses should be adopted that permit productive lines of questioning to be taken to their conclusion and allow all interested PAC members an adequate opportunity to participate.

Public Accounts Committees should focus on significant issues of management and financial administration rather than on isolated, individual transactions.

Public Accounts Committees should prepare substantive reports at least annually containing a summary of findings, a statement of conclusions, and recommendations for action to be taken by the government.

Wherever possible, Public Accounts Committee reports should be arrived at through a consensus of all members of the committee.

Legislatures should set aside time to debate the reports of Public Accounts Committees at least annually.

Public Accounts Committees should adopt an effective procedure for following up their recommendations with administration.

Wherever possible and appropriate audit reports should incorporate responses by the audited organizations to the auditor's comments and recommendations.

Auditors and/or members of the audit staff should attend hearings of Public Accounts Committees to act and be used as a source of expert advice to the committees.

Public Accounts Committees should make use of auditors as advisers while preparing the agendas and reports and in briefings prior to their hearings.

Public Accounts Committees should discuss with the auditors the most appropriate manner of using the services of the audit offices to follow up committee recommendations.

---