

## Chapter 3: Assessment of Public Financial Management (PFM) Performance

### A PFM Out-Turns – Budget Credibility

#### PI-1 Aggregate expenditure out-turn compared to original approved budget

Overall rating ‘D’

3.1 The ability to implement the budgeted expenditure is an important factor in supporting the government’s ability to deliver the public services for the year as expressed in policy statements, output commitments and work plans. The indicator reflects this by measuring the actual total expenditure compared to the originally budgeted total expenditure but excludes debt service payments, and donor funded project expenditure. This measure provides an assurance whether the PFM system is delivering effective fiscal discipline and responsive to changes in macro-economic situations in accordance with budget intentions. The use of original estimates as approved by the legislature instead of revised budget figures ensures that the indicator measures the process of estimation as well as the execution in line with the same. The following table describes the rating criteria for scoring the aggregate expenditure out-turn:

Score	Minimum Requirements
<b>A</b>	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.
<b>B</b>	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10 % of budgeted expenditure.
<b>C</b>	(i) In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.
<b>D</b>	(i) In two or all of the last three years did the actual expenditure deviate from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure.

3.2 The following figures, showing the differences between actual expenditures and the originally budgeted expenditures over the three years to FY 2004-05, are drawn from the Annual Budgets as approved by the Provincial Assembly, the respective Final Accounts, and Planning and Development Department, in case of development expenditures:

<b>Aggregate Expenditure<sup>2</sup></b>	<b>Rs. in Millions</b>		
<b>Particulars</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
Budgeted	48,383	48,671	45,803
Actual	33,763	38,123	44,705
Deviation	14,620	10,548	1,098
Percentage Deviation	-30.22%	-21.67%	-2.40%

<sup>2</sup> The classification of expenditures changed over the years under consideration; therefore, to avoid any doubts in the comparison of primary expenditures as to deduction of debt servicing and foreign aided projects, the aggregate expenditures are taken for analysis. In any case, the deduction would amount to greater deviation in percentage terms.

3.3 As shown above, within the three years, the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure in two years; therefore a rating of ‘D’ is assigned to this indicator.

3.4 Without prejudice to the foregoing, the following additional constraints are noted:

- i) extraordinary expenditures in relation to the cost of devolution, and the effects of fiscal decentralization itself, have impacted the expenditure out-turns of the given years to a great extent,
- ii) the practice of keeping establishment / salary budget for all posts sanctioned instead of making a realistic estimate on how many of the posts would be filled during the year and what contribution they would make to actual salary costs,
- iii) limited capacity to implement developmental schemes,
- iv) a disconnect between the budgeting and procurement cycles resulting in loss of considerable time before the development expenditures pick up pace,
- v) delays in release of budget appropriations and related information to the last level of expenditure DDOs, and
- vi) budgeting to expend a higher than expected hydel profits which remained un-realized during the first two out of the three years under review.

**PI-2 Composition of expenditure out-turn compared to the original approved budget**

Overall rating ‘C’

3.5 Where the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent. Measurement against this indicator requires an assessment of expenditure out-turns against the original budget at a sub-aggregate level. As budgets in NWFP are usually reported and managed on a functional basis, this basis was used for this indicator. At the functional level, variances were calculated for the main budgetary heads that are included in the approved Annual Budget Statement. Budget realism is a measure to assess the estimation process and the effectiveness of budgetary controls during execution. To meet the PFM Framework’s highest criterion, the composition of expenditures needs to be close to budget. The following table describes the rating criteria for scoring the composition of expenditure out-turn:

<b>Score</b>	<b>Minimum Requirements</b>
<b>A</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last three years.
<b>B</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years.
<b>C</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.
<b>D</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least two out of the last three years.

3.6 The following tables provide the relevant data for measurement of PI-2:

Primary Expenditure Particulars	Rupees in millions					
	2002-03 Budget	2002-03 Actual	2003-04 Budget	2003-04 Actual	2004-05 Budget	2004-05 Actual
General Administration / General Public Serv.	4,612	3,763	4,845	3,723	15,647	14,902
Law & Order / Public Safety	3,171	3,141	3,087	3,346	4,066	4,318
Community Services / Social Protection	1,489	870	911	909	132	207
Social Services / Health / Education	14,080	13,982	14,087	14,111	2,959	2,920
Economic Services / Economic Affairs / Environmental Protection	3,617	2,210	2,805	4,195	5,346	4,067
/ Housing and Community					247	253
/ Recreation					475	477
Subsidies	1,000	800	1,000	700	133	139
Unallocable	10,912		9,533			

  

Year	For PI-1 total expenditure deviation	Total average expenditure variance by composition	For PI-2 variance in excess of total deviation
FY2002/3	30.22%	36.31%	6.09%
FY2003/4	21.67%	34.82%	13.15%
FY2004/5	2.40%	6.04%	3.64%

3.7 Based on the above figures, in two out of the three years, expenditure composition exceeded overall deviation in primary expenditure by at least 5 percentage points. Therefore, the rating for the indicator has been assessed as 'C', in accordance with the rating methodology. This is primarily due to two reasons: (i) the earlier practice (fiscal years 2002-03 and 2003-04) of keeping part of the original approved appropriations in an 'unallocable' head and then re-appropriating / re-allocating these to other expenditure heads during the year, thus creating compositional variance amongst the budget heads, while keeping the overall expenditures as planned, and (2) a change, during the three year reference period, in the budget classification from the Chart of Classification (CoC) to the new Chart of Accounts (CoA) – the latter being better international standard. However, the practice of keeping unallocable has been refined after introduction of NAM and it can be observed that no funds are kept under the head 'unallocable'.

### PI-3 Aggregate revenue out-turn compared to the original approved budget Overall rating 'D'

3.8 Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted expenditure allocations are based upon that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting. The following table describes the rating criteria for scoring the aggregate revenue out-turn:

Score	Minimum requirements
A	(i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.
B	(i) Actual domestic revenue collection was below 94% of budgeted domestic revenue estimates in no more than one of the last three years.

C	(i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no more than one of the last three years.
D	(i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in two or all of the last three years.

3.9 The following tables provide the relevant data for measurement of PI-2:

Particulars	Aggregate Revenue		
	Rupees in million		
	FY 2002-03	FY 2003-04	FY 2004-05
Budgeted	51,440	55,289	50,858
Actual	38,436	38,190	48,004
Actual as a percentage of Budgeted	74.72%	69.07%	94.39%

3.10 Since actual revenue collection in two years was below 92%, the PI-2 is given a rating of 'D'.

3.11 As a high proportion of the total receipts are due from the federal government, the rating only partially reflects the provincial government-own performance to collect revenue from taxpayers. In addition, the outstanding issue of *hydel profits* is one of the reasons contributing to the deviation of actual receipts vis-à-vis the budgeted receipts.

#### PI-4 Stock and monitoring of expenditure payment arrears

Overall rating 'D'

3.12 Expenditure payment arrears are expenditure obligations that have been incurred by the government, for which payment to the employee, supplier, contractor or loan creditor is overdue. In the absence of such information, a number of different problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and non-transparent financing, would persist. The following table describes the rating criteria for scoring the stock and monitoring of expenditure payment arrears:

Score	Minimum Requirements
<b>A</b>	(i) The stock of arrears is low (i.e. is below 2% of total expenditure) (ii) Reliable and complete data on the stock of arrears is generated through routine procedures at least at the end of each fiscal year (and includes an age profile).
<b>B</b>	(i) The stock of arrears constitutes 2-10% of total expenditure; and there is evidence that it has been reduced significantly (i.e. more than 25%) in the last two years. (ii) Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.
<b>C</b>	(i) The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years. (ii) Data on the stock of arrears has been generated by at least one comprehensive ad hoc exercise within the last two years.
<b>D</b>	(i) The stock of arrears exceeds 10% of total expenditure. (ii) There is no reliable data on the stock of arrears from the last two years.

3.13 There is evidence to show that a reasonable amount of arrears is generated in the normal conduct of business even where such arrears are in memorandum form and are liquidated only at the start of a subsequent fiscal year when budgets become available for spending.

3.14 The GoNWFP’s current accounting system does not differentiate between an expenditure and payment of arrears under a particular expenditure head. No liabilities are currently recorded at the time of the incurrence of expenditure as commitments and obligations are not considered as part of the province’s accounting process at the moment. Therefore the stock or total payment of arrears in a particular period cannot be discerned. In the absence of such information, a number of different problems persist, such as inadequate commitment controls (including overspending against the budget during a manual budget execution process), cash rationing, inadequate budgeting for contracts, under-budgeting of specific items, and non-transparent financing. The incidences of stock of payment arrears accrue largely at the TMA levels. Since, however, no data are kept or maintained in relation to stock of arrears, a rating of “D” is assigned to this indicator in accordance with the PFM Framework scoring scale.

3.15 The weaknesses associated with unavailability of arrears data could be substantially resolved after the full implementation of the NAM/SAP system, which includes commitment accounting. In addition, it is important to ensure that the new system separately identifies the payment of arrears from other routine payments pertaining to a current fiscal year.

## **B Key Cross-Cutting Issues: Transparency and Comprehensiveness**

### **PI-5 Classification of the Budget**

Overall rating ‘A’

3.16 The PFM Framework looks for a robust classification system that allows the tracking of spending on the following dimensions: administrative unit, economic, functional and program. Where standard international classification practices are applied, governments can report expenditure in GFS format and track poverty-reducing and other selected groups of expenditure. The following table describes the rating criteria for PI-5 – classification of budget:

<b>Score</b>	<b>Minimum Requirements (Scoring Method M1)</b>
<b>A</b>	(i) The budget formulation and execution is based on administrative, economic and sub-functional classification, using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional.)
<b>B</b>	(i) The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.
<b>C</b>	(i) The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.
<b>D</b>	(i) The budget formulation and execution is based on a different classification (e.g. not GFS compatible or with administrative break-down only).

3.17 The NWFP government became the first province to adopt the new Chart of Account (COA) under NAM is the fiscal year 2004-05. The budget for the year 2005-06 was also prepared under the new NAM COA, which is compliant with the UN-supported Classification of Functions of Government (COFOG) and IMF GFS. Since the last two years budgets are prepared under NAM COA and the next years budget (i.e. 2006-07) has also been prepared on the same NAM COA basis, a rating of ‘A’ is assigned to this indicator. The new classification system now allows the tracking of spending under all parameters as accounting follows the budget coding structure.

## PI-6 **Comprehensiveness of information included in Budget Documentation**

Overall rating 'B'

3.18 The annual budget documentation (the annual budget and budget supporting documents), as submitted to the legislature for scrutiny and approval, should allow a complete picture of government fiscal forecasts, budget proposals and out-turn of previous years. In addition to the detailed information on revenues and expenditures, and in order to be considered complete, the annual budget documentation should include information on the following elements:

- i) Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate;
- ii) Fiscal deficit, defined according to GFS or other internationally recognized standard;
- iii) Deficit financing, describing anticipated composition;
- iv) Debt stock, including details at least for the beginning of the current year;
- v) Financial assets, including details at least for the beginning of the current year;
- vi) Prior year's budget outturn, presented in the same format as the budget proposal;
- vii) Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal;
- viii) Summarized budget data for both revenue and expenditure according to the main heads of the classifications used, including data for the current and previous year; and
- ix) Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.

3.19 The following table describes the rating criteria for PI-6 – budget comprehensiveness – dimension (i)

<b>Score</b>	<b>Minimum Requirements (Scoring Method M1)</b>
<b>A</b>	(i) recent budget documentation fulfils 7-9 of the 9 information benchmarks
<b>B</b>	(i) recent budget documentation fulfils 5-6 of the 9 information benchmarks
<b>C</b>	(i) recent budget documentation fulfils 3-4 of the 9 information benchmarks
<b>D</b>	(i) recent budget documentation fulfils 2 or less of the 9 information benchmarks

3.20 The annual budget documentation of NWFP government includes the budget speech, annual budget statement and detailed statements of receipts, current expenditures and the annual development program. In addition, a supplementary budget statement of last year and a "White Paper", presenting explanations of budgetary allocations and budgetary trends form a part of the budget documents. These documents provide information relating to receipts and expenditures from both the consolidated fund and the public account managed through government account # 1. Information is also provided in respect of the operation of government account # 2 relating to trading. Revised estimates of the preceding year are provided for comparison with the estimates for the current year's budget. Three forward years' forecasts for receipts and expenditures are also shown as part of the Medium Term Budget Framework (MTBF). A statement of the public debt,

bifurcated into domestic loans (i.e. federal government loan) and foreign loans, is included as part of the White Paper, which also provides information in relation to repayment schedule, rate of interest, number of installments and outstanding liabilities. In addition, the White Paper also provides brief details of debt servicing and premature debt retirement.

3.21 On the basis of the evidenced adduced, the annual budget documentation does not include information regarding financial assets (v), and prior year’s budget outturn (vi) In accordance with the PFM scoring methodology, since only 2 out of 9 elements are not complied with, a rating of ‘B’ is applicable to the indicator.

**PI-7 Extent of unreported government operations**

Overall rating ‘D+’

3.22 Comprehensive and effective budgeting demands that the budget process should control all revenues, expenditures and financing of the provincial government. An effective and efficient project and financial management system ensures transparency and accountability through periodic project status reports and fiscal management reports. Often donor project funding is partially outside government control. The line departments in charge of implementing donor-funded projects should at least be able to provide adequate financial reports on the receipt and use of donor funding received in cash.

3.23 The following two dimensions are to be assessed:

- i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports – ‘A’.
- ii) Income/expenditure information on donor-funded projects which is included in fiscal reports – ‘D’.

3.24 The following table describes the rating criteria:

<b>Dimension</b>	<b>Minimum requirements</b>
<b>A</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure). (ii) Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind OR donor funded project expenditure is insignificant (below 1% of total expenditure).
<b>B</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 1-5% of total expenditure. (ii) Complete income/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects.
<b>C</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 5-10% of total expenditure. (ii) Complete income/expenditure information for all loan financed projects is included in fiscal reports.
<b>D</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes more than 10% of total expenditure. (ii) Information on donor financed projects included in fiscal reports is seriously deficient and does not even cover all loan financed operations.

3.25 Despite some improvements, accounting and reporting of foreign aid remains an issue due to the variety of systems operating for disbursing and accounting for foreign project assistance. Some of these systems allow disbursements to be made and accounted outside the provincial budgeting and accounting systems. Significant disbursements/reimbursements continue to be made by donors directly into assignment accounts established for the implementation of foreign-assisted projects. Expenditures financed from assignment accounts are recorded by the public accounting system in lump only when advances are made to these accounts, whereas the detailed expenditure by function cum object classification is recorded when the project entities inform the Accountant General of these expenditures. The Circular on the procedures for operation and maintenance of revolving fund accounts issued by the Federal MoF (25 November 2002) and when fully complied with, will ensure that foreign aid resources will be captured in the budgets, and the expenditures accounted for and reported as part of the overall expenditures of NWFP.

3.26 In addition, the personal ledger accounts are operated usually to fund development expenditures. The composite balance controls are exercised by the treasury office; however, the detailed accounts are kept by the Divisional Accountants under the supervision of the Project Directors. Although not strictly an infringement from the comprehensiveness aspect of the budget, non-clearance of suspense balances and the personal ledger accounts are sources of discrepancies that arise in budgetary expenditures and their financing, thus adversely affecting the government's accounting and budgetary systems and compromising the transparency and comprehensiveness of the provincial budget management. The PLAs and Assignment Accounts fiscal reports are not classified according to the government Chart of Accounts except at the function/sub-function levels.

3.27 At the provincial level, since the amount of unreported expenditures, other than those relating to donor-funded operations, is insignificant (estimated at below 1%); dimension (i) scores 'A'. However, income/expenditure information captured in the fiscal reports, including those related to donor-financed projects, has always been incomplete; therefore, dimension (ii) scores 'D'. This is clearly as result of not using government systems for donor-financed investment projects. On the basis of the scoring methodology, the overall score of "D+" is therefore assigned to this indicator.

## **PI-8 Transparency of inter-government fiscal relations**

Overall rating 'B'

- i) Transparent and rules based systems in the horizontal allocation among lower level governments of unconditional and conditional transfers (both budgeted and actual allocations) – 'A'.
- ii) Timeliness of reliable information to lower level governments on their allocations for the coming year – 'C+'.
- iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sector categories – 'C'.

3.28 While the performance indicator set is focused on PFM by provincial government, local governments also have wide-ranging expenditure responsibilities. For local governments, specific laws determine their respective layers of government as well as the expenditure responsibilities and revenue sharing arrangements. Transfers falling in these categories are usually unconditional (or block) grants, the use of which will be determined by local governments through their budgets process. In addition, the provincial government may provide conditional grants to local governments to implement selected service delivery and expenditure responsibilities - e.g. by function or program, on a case-by-case basis.

3.29 The following table describes the rating criteria for PI-8:

<b>Dimension</b>	<b>Minimum requirements for dimension score.</b>
(i) Transparency and objectivity in the horizontal allocation among SP governments	<p><b>Score = A:</b> The horizontal allocation of almost all transfers (at least 90% by value) from provincial government is determined by transparent and rules-based systems</p> <p><b>Score = B:</b> The horizontal allocation of most transfers from provincial government (at least 50% of transfers) is determined by transparent and rules-based systems.</p> <p><b>Score = C:</b> The horizontal allocation of only a small part of transfers from provincial government (10-50%) is determined by transparent and rules-based systems.</p> <p><b>Score = D:</b> No or hardly any part of the horizontal allocation of transfers from provincial government is determined by transparent and rules-based systems.</p>
(ii) Timeliness of reliable information to SP governments on their allocations	<p><b>Score = A:</b> SP governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes.</p> <p><b>Score = B:</b> SP governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible.</p> <p><b>Score = C:</b> Reliable information to SP governments is issued before the start of the SP fiscal year, but too late for significant budget changes to be made.</p> <p><b>Score = D:</b> Reliable estimates on transfers are issued after SP government budgets have been finalized, or earlier issued estimates are not reliable.</p>
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories	<p><b>Score = A:</b> Fiscal information (ex-ante and ex-post) that is consistent with provincial government fiscal reporting is collected for 90% (by value) of SP government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.</p> <p><b>Score = B:</b> Fiscal information (ex-ante and ex-post) that is consistent with provincial government fiscal reporting is collected for at least 75% (by value) of SP government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year.</p> <p><b>Score = C:</b> Fiscal information (at least ex-post) that is consistent with provincial government fiscal reporting is collected for at least 60% (by value) of SP government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year.</p> <p><b>Score = D:</b> Fiscal information that is consistent with provincial government fiscal reporting is collected and consolidated for less than 60% (by value) of SP government expenditure OR if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all.</p>

3.30 The overall level of grants (i.e. the vertical allocation) will usually be budget policy decisions at the provincial government’s discretion or as part of constitutional negotiation processes and is not assessed by this indicator. However, clear criteria, such as formulas for the distribution of grants among local government entities (i.e. horizontal allocation of funds) are needed to ensure allocation transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by local governments. It is also crucial for local governments that they receive firm and reliable information on annual allocations from provincial government preferably before commencement of their own budget preparation processes.

3.31 Provincial-to-local government transfers have been determined under the annual interim Provincial Finance Commission (PFC) Award for the past three years, partly due to the absence of a new NFC Award. The principal fiscal transfers to local governments are derived from a share of the provincial divisible pool, which is based on the provincial pool, minus provincial obligatory expenditures. The horizontal allocation of funds among the local governments is based on transparent and rule-based systems. Dimension (i) is therefore rated 'A'.

3.32 The timeliness of reliable information to the local governments about the funds transfer remains an issue to be managed. The local governments can make their own reasonable estimates of what to expect. The provincial budgeting process is usually not completed until end June. Furthermore, the uncertainty in the collection of the future expected revenues also creates uncertainty in the expected shares of the revenues for local governments. In an environment of less buoyant revenues and high uncertainties as regards the expected ‘hydel profits’, dimension (ii) is therefore rated 'C'.

3.33 The extent of consolidation of fiscal data for local governments with those of the provincial government according to sectoral categories is poor. With the implementation of NAM, the fiscal information that is consistent with provincial government fiscal reporting is collected and consolidated only at the district government level and later reflected in the monthly civil accounts and the Finance Accounts. The information regarding the other local government tiers (below district government levels) is not consolidated into the accounts of the provincial government. On the basis of this, dimension (iii) is rated 'C'.

3.34 Based on the M2 scoring methodology, this indicator is, overall, assigned a rating of “B”.

**PI-9 Oversight of aggregate fiscal risk from other public sector entities**  
Overall rating ‘C’

3.35 Provincial governments usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks with national implications arising from activities of local governments, autonomous government agencies (AGA) and public enterprises (PE), including state-owned banks. They may also assume the responsibility for financial default of the other public sector entities, not formally under their oversight, due to political reasons. Local government can create fiscal risks. Their AGAs and PEs can be subject to debt service defaulting (with or without guarantees issued by provincial government). There can be expenditure payment arrears and unfunded pension obligations.

3.36 The PFM Framework criterion looks for well-established procedures for monitoring SOEs and local governments on a timely basis. It also assesses the extent of provincial government’s monitoring of local governments’ fiscal position. Two dimensions are to be assessed:

- i) Extent of monitoring of AGAs and PEs – ‘C’.
- ii) Extent of monitoring of lower level governments’ fiscal position – ‘C’.

3.37 For dimension (i), although, financial statements of most AGAs and PEs are available to the provincial government annually, there is no consolidated overview of their overall fiscal risk situation for effective monitoring. As a result, a rating of ‘C’ is applicable to the dimension.

3.38 Also some form of systematic monitoring of local governments (districts) is carried out despite the lack of proper consolidation of the fiscal position of those governments being carried out by the provincial government, the rating of ‘C’ applies to the rating dimension (ii).

3.39 Accordingly therefore, an overall rating of ‘C’ is assessed for the indicator.

Score	Minimum requirements
<b>A</b>	(i) All major AGAs/PEs submit fiscal reports to provincial governments at least six-monthly, as well as annual audited accounts, and provincial government consolidates fiscal risk issues into a report at least annually. (ii) SN government cannot generate fiscal liabilities for provincial government OR the net fiscal position is monitored at least annually for all levels of SN government and provincial government consolidates overall fiscal risk into annual (or more frequent) reports.
<b>B</b>	(i) All major AGAs/PEs submit fiscal reports including audited accounts to provincial governments at least annually, and provincial government consolidates overall fiscal risk issues into a report. (ii) The net fiscal position is monitored at least annually for the most important level of SN government, and provincial government consolidates overall fiscal risk into a report.
<b>C</b>	(i) Most major AGAs/PEs submit fiscal reports to provincial governments at least annually, but a consolidated overview is missing or significantly incomplete. (ii) The net fiscal position is monitored at least annually for the most important level of SN government, but a consolidated overview is missing or significantly incomplete.
<b>D</b>	(i) No annual monitoring of AGAs and PEs takes place, or it is significantly incomplete. (ii) No annual monitoring of SN governments’ fiscal position takes place or it is significantly incomplete.

3.40 The GoNWFP should monitor and manage fiscal risks arising from its own activities, other local government entities and from state-owned enterprises (SOEs) activities. The GoNWFP owns many public enterprises. Various departments of provincial government have been assigned the responsibility of monitoring the operations of commercial and financial activities of public enterprises under their jurisdiction; however, no systematic overview is maintained. The governing bodies / boards of such enterprises generally have significant operational autonomy; yet there are requirements of pre-approvals and clearances to be provided by the responsible government departments for activities and decisions recognized as critical.

3.41 Provincial government should require and receive quarterly financial statements and audited year-end statements from SOEs, and monitor performance against financial targets. AGAs and PEs often report to parent line ministries, but consolidation of information is important for overview and reporting of the total fiscal risk that the provincial government is exposing itself to. Where local governments can generate fiscal liabilities for provincial government, their fiscal position should be monitored, at least on an annual basis, again with consolidation of the essential fiscal information.

3.42 The records of contingent liabilities and guarantees given in respect of provincial public enterprises cannot be found at one place. Borrowing for investment purposes by major public enterprises is included in the Annual Development Program (ADP). This presentation does not include borrowing plans of major public sector corporations. Moreover, by seeking (and obtaining) provincial government’s guarantees for their borrowings, some of these enterprises are responsible for the bulk of the provincial government’s contingent liabilities, both existing and potential. More comprehensive and frequent information on SOE fiscal risks is needed. The GoNWFP 2003-04 Audit Report revealed that the NWFP Highways Authority, being a corporate body, was required to maintain complete and accurate accounts. It was supposed to render accounts to AG NWFP by August 31<sup>st</sup> of each year. The report pointed out that the Authority, established in 2001, had neither framed rules nor prepared annual financial statements as required under its Ordinance. AGAs/PEs are required to submit fiscal reports to the provincial government and/or to their governing bodies at least annually, but a consolidated overview by the government has always been missing. The 2003 NWFP provincial financial accountability assessment found that the SOE monitoring processes needed to be resuscitated.

3.43 The NWFP Local Government Ordinance, 2001 prohibits the local governments from borrowing. However, in the absence of an effective and efficient fiscal discipline at the local government level, there is a tendency to over-commit future resources beyond the reasonable fiscal space.

3.44 The NWFP LGO also provides for collection of fiscal information by sub-national governments for the purposes of PFC deliberations and analysis. The data needs to be collected on a quarterly basis; however, there are practical problems and low capacity hindering the implementation of the legislation.

**PI-10 Public access to key fiscal information**

Overall rating ‘C’

3.45 Transparency depends on whether the information on fiscal plans, positions and performance of the government is easily accessible to the general public or at least to the relevant interest groups. Elements of information to which public access is essential include: (i) Annual budget documentations; (ii) In-year budget execution reports; (iii) Year-end financial statements; (iv) External audit reports; (v) Contract awards; and (vi) Resources available to primary service units. The scoring criteria for PI-10 are given in the following table:

Score	Minimum Requirements (Scoring Method M1)
<b>A</b>	(i) the government makes available to the public 5-6 of the 6 listed types of information
<b>B</b>	(i) the government makes available to the public 3-4 of the 6 listed types of information
<b>C</b>	(i) the government makes available to the public 1-2 of the 6 listed types of information
<b>D</b>	(i) the government makes available to the public none of the 6 listed types of information

3.46 The PFM Framework looks for comprehensive and timely publication of relevant financial information, readily accessible external audit reports and contract awards provided in a clear and easily comprehensible format through easily accessible and cost effective media to the general public.

3.47 Monthly Civil Accounts provided to government agencies by the Accountant General present provisional information on budget execution. This gives a complete account of provincial revenue, expenditure and financing as well as the stock position of provincial cash balances on monthly and progressive basis. As per set standards, the Civil Accounts are available after the second week of succeeding month. The “provisional actual” budgetary outcomes are available after three months of the close of every fiscal year. The actual out-turn data, however, are provided but with a longer time lag.

3.48 The annual accounts, known as the Finance Accounts, compiled by the Accountant General are made public after having been audited by the Auditor General of Pakistan and laid before the Provincial Assembly through the Governor. The Constitution or any other law does not provide any time limit for rendering accounts before the legislature/public. Only the provisional figures (i.e. revised estimates) are available as part of the budget documents.

3.49 Similarly, audit reports are made available with a significant time lag and no action is taken to make them publicly available. There are no within-year budget execution reports accessible to public. The understandability and appropriateness of layout of detailed budget documents and finance accounts can be improved considerably. Quick and easy access to the relevant financial management data to the public remains a major issue.

3.50 GoNWFP is also maintaining a website ([www.nwfpfinance.com](http://www.nwfpfinance.com)) through which some of the financial data can be easily accessible. This website also gives reasonable information on the functioning of the GoNWFP. Brief links are also maintained about all the relevant departments that give basic information to visitors.

3.51 The public access to the procurement related information is minimal. Tender notices, other than those coming under international competitive bidding (ICB), are either not advertised in widely circulated newspapers, or the response time allowed is too short to elicit a healthy response. Similarly, there is no access to information about the final award in tender exercises or the final disposal of appeals. All procurement notices, award information, complaints and appeals information are, as a matter of routine, not available to the general public or posted on a website.

3.52 Based on the above analysis, only dimensions (i) and (iii) may reasonably be considered to be publicly available. Even then, there is a significant delay between the time the year-end financial statements (dimension (iii)) are available and the time they can be accessed by the public. Accordingly, this indicator is assigned a score of “C”.

## **C Budget Cycle**

### **PI-11 Orderliness and Participation in Annual Budget Process**

2.0 Overall rating ‘A’

3.53 The three dimensions assessed and their respective sub-ratings are provided as below:

- i) Existence of and adherence to a fixed budget calendar – ‘A’.
- ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent) – ‘A’.
- iii) Timely budget approval by the legislature or similarly mandated body (within the last three years) – ‘A’.

3.54 The PFM Framework looks for a system whereby spending ministries are given clear guidance for the preparation of budget submissions, including indicative ceilings that are informed by specific agreement at the political level on the relative spending priorities across sectors.

Provincial departments should adhere to the budget calendar and be generally able to fulfill the requirements of the budget calendar, including ceilings and data submissions. Negotiations with department of finance should be open and transparent and line departments should know their final allocation at the conclusion of such negotiations. The Constitution itself sets the basis of budget formulation by defining the provincial consolidated fund, public account, charged expenditures and other provisions relating to financial management.

3.55 The criteria for assessment are given in the following table:

Dimension	Minimum requirements for dimension score.
(i) Existence of and adherence to a fixed budget calendar	<p><b>Score = A:</b> A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time.</p> <p><b>Score = B:</b> A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time,</p> <p><b>Score = C:</b> An annual budget calendar exists, but is rudimentary and substantial delays may often be experienced in its implementation, and allows MDAs so little time to complete detailed estimates, that many fail to complete them timely.</p> <p><b>Score = D:</b> A budget calendar is not prepared OR it is generally not adhered to OR the time allowed for MDAs' budget preparation is clearly insufficient to make meaningful submissions.</p>
(ii) Guidance on the preparation of budget submissions	<p><b>Score = A:</b> A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs.</p> <p><b>Score = B:</b> A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission.</p> <p><b>Score = C:</b> A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by Cabinet only after they have been completed in all details by MDAs, thus seriously constraining Cabinet's ability to make adjustments.</p> <p><b>Score = D:</b> A budget circular is not issued to MDAs OR the quality of the circular is very poor OR Cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus having no opportunities for adjustment.</p>

(iii) Timely budget approval by the legislature	<p><b>Score = A:</b> The legislature has, during the last three years, approved the budget before the start of the fiscal year.</p> <p><b>Score = B:</b> The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.</p> <p><b>Score = C:</b> The legislature has, in two of the last three years, approved the budget within two months of the start of the fiscal year.</p> <p><b>Score = D:</b> The budget has been approved with more than two months delay into of the last three years.</p>
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3.56 The practice followed by the provincial government involves the issuance of a Budget Call Circular to all departments and agencies, normally in October, for the preparation of next fiscal year budget. This also includes the budget calendar. The practice entails formulation of development and recurrent budgets by the line departments. These are then negotiated between the Finance, P&D and line departments on the basis of the available resource envelope and competing demands on the financial resources. The process, which continues for at least a couple of months and involves several iterations, gives the heads (secretaries) of line departments to argue and defend adequate provision of financial resources to their respective departments. The draft budget formulated through this process is then presented to the provincial Cabinet for final and higher level negotiations. The Cabinet finalizes the budget to be put before the Provincial Assembly for approval. The budget is then presented to the Provincial Assembly normally during the 1<sup>st</sup> or 2<sup>nd</sup> week of June and approved by June 30. On the basis of the above justifications, all three 3 dimensions are respectively rated 'A' and, accordingly, the overall rating of the indicator is 'A'.

**PI-12 Multi-year perspective in fiscal planning, policy and budgeting**  
Overall rating 'B'

3.57 The four related dimensions for this indicator and their respective sub-ratings as below:

- i) Preparation of multi -year fiscal forecasts and functional allocations – 'A'.
- ii) Scope and frequency of debt sustainability analysis – 'A'.
- iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure – 'C'.
- iv) linkages between investment budgets and forward expenditure estimates – 'C'.

3.58 Expenditure policy decisions have multi-year implications, and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, medium term expenditure aggregates for mandatory expenditure and potential deficit financing (including reviews of debt sustainability involving both external and domestic debt) supported by debt sustainability analyses and costed sector strategies must be the foundation for policy changes. In summary, the PFM Framework looks for government's ability to develop a medium-term perspective in fiscal planning, expenditure policy and budgeting with at least three years on a rolling annual basis.

Dimension	Minimum requirements for dimension score.
(i) Multi-year fiscal forecasts and functional allocations	<p><b>Score = A:</b> Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained</p> <p><b>Score = B:</b> Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained.</p> <p><b>Score = C:</b> Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis.</p> <p><b>Score = D:</b> No forward estimates of fiscal aggregates are undertaken</p>
(ii) Scope and frequency of debt sustainability analysis	<p><b>Score = A:</b> DSA for external and domestic debt is undertaken annually.</p> <p><b>Score = B:</b> DSA for external and domestic debt is undertaken at least once during the last three years.</p> <p><b>Score = C:</b> A DSA for at least for external debt undertaken once during last three years.</p> <p><b>Score = D:</b> No DSA has been undertaken in the last three years</p>
(iii) Existence of costed sector strategies	<p><b>Score = A:</b> Strategies for sectors representing at least 75% of primary expenditure exist with full costing of recurrent and investment expenditure, broadly consistent with fiscal forecasts.</p> <p><b>Score = B:</b> Statements of sector strategies exist and are fully costed, broadly consistent with fiscal forecasts, for sectors representing 25-75% of primary expenditure.</p> <p><b>Score = C:</b> Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure OR costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts.</p> <p><b>Score = D:</b> Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.</p>

(iv) Linkages between investment budgets and forward expenditure estimates	<p><b>Score = A:</b> Investments are consistently selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p><b>Score = B:</b> The majority of important investments are selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p><b>Score = C:</b> Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.</p> <p><b>Score = D:</b> Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.</p>
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3.59 The Budget White Paper of GoNWFP does have a schedule that provides a Medium Term Budgetary Framework (MTBF) covering four years (the budget year and three forward years' estimates) and showing revenues and grants estimates for development and current expenditure items, as well as district government transfers. Therefore, dimension (i) is rated as 'A'. The White Paper also contains significant information on debt, further showing that debts with heavy debt servicing requirements have been prematurely retired and replaced by more sustainable debts arrangements. Debt sustainability analysis is regularly carried out especially as this is a requirement to be conducted before annual budget support operations (NWFP DPCs) are undertaken. Thus, dimension (ii) is also scored 'A'.

3.60 The Economic Report of GoNWFP dated December 8, 2005 stated that one of the main reasons for inefficient public expenditures is that the public investment program is not aligned with the goals and targets of growth, poverty reduction and human and social development set by the province. It also recommends that the government should start implementing the rolling medium-term budget framework (MTBF) more closely focused on the goals, and the effectiveness of this as a planning tool should be heightened. If regular consultations with major shareholders are made a part of the process, the disconnect existing between the policy goals and the expenditure profile would be more effectively addressed. There is no coherent integration of the development and the recurrent budgets as these are all stand-alone documents. Since existence of linkages between sector strategies and multi-year development and recurrent expenditure estimates remain absent for at least 75% of the sectors, and the recurrent cost impact of most investment decisions are not integrated and included in the forward estimates under the MTBF, dimensions (iii) and (iv) are rated 'C'. Overall, therefore, and according to the scoring methodology for the indicator, a rating of 'B' applies.

### **PI-13 Transparency of Taxpayer Obligations and Liabilities**

Overall rating 'C+'

3.61 Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system, but is also very dependent on the direct involvement and co-operation of the taxpayers from the individual and the corporate private sector. Their contribution to ensuring overall compliance with tax policy is encouraged and facilitated by a high degree transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard, and the ability to contest administrative rulings on tax liability. A good tax collection system encourages compliance and limits individual negotiation of tax liability by ensuring that tax legislation is clear and comprehensive and that it limits discretionary powers (especially in decisions on tax assessments and exemptions) of the collectors.

3.62 The three dimensions assessed and their respective sub-ratings are as follows:

- i) Clarity and comprehensiveness of tax liabilities – ‘C’.
- ii) Taxpayer access to information on tax liabilities and administrative procedures – ‘B’.
- iii) Existence and functioning of a tax appeals mechanism – ‘C’.

3.63 The assessment criteria are given in the following table:

<b>Dimension</b>	<b>Minimum requirements for dimension score.</b>
(i) Clarity and comprehensiveness of tax liabilities	<p>Score = A: Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved.</p> <p>Score = B: Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved.</p> <p>Score = C: Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved.</p> <p>Score = D: Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities.</p>
(ii) Taxpayers’ access to information on tax liabilities and administrative procedures	<p>Score A: Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for all major taxes, and the RA supplements this with active taxpayer education campaigns.</p> <p>Score = B: Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited.</p> <p>Score = C: Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date.</p> <p>Score = D: Taxpayer access to up-to-date legislation and procedural guidelines is seriously deficient.</p>
(iii) Existence and functioning of a tax appeals mechanism.	<p>Score A: A tax appeals system of transparent administrative procedures with appropriate checks and balances, and implemented through independent institutional structures, is completely set up and effectively operating with satisfactory access and fairness, and its decisions are promptly acted upon.</p> <p>Score = B: A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.</p> <p>Score = C: A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective.</p> <p>Score = D: No functioning tax appeals system has been established</p>

3.64 The Board of Revenue and Excise & Taxation are the two major revenue administration departments for GoNWFP. All receipts are deposited with the State Bank of Pakistan (SBP) or the National Bank of Pakistan, acting as an agent of SBP. The Board of Revenue is the controlling authority in all matters connected with administration of the land, collection of land revenue, preparation of land records, and other relevant matters. Excise and Taxation perform the functions of a collecting agency for the Government of NWFP in respect of a number of taxes including Urban Immovable Property Tax, Motor Vehicle Tax, Motor Vehicle Registration Fee, Entertainment Duty, Tax On Trade, Provincial Excise Duty, Registration of Motor Vehicles, Dealers and Real Estate Agents, etc.

3.65 The prevailing tax culture, the overall control environment, and the relevant tax systems of GoNWFP need substantial improvements. The legislation and procedures for most of the taxes are reasonably comprehensive and clear, but the fairness of the system is debatable due to the prevalent practice of exercising discretionary powers in exempting penalties, and in making fair and objective tax liabilities assessment. Ensuring that taxpayers comply with their procedural obligations for taxpayer registration and tax declaration is usually encouraged by penalties that may vary with the seriousness of the fault. The effectiveness of such penalties is determined by the extent to which penalties are sufficiently high to have the desired impact, and are consistently and fairly administered. However, in the current GoNWFP tax administration culture, the penalties for non-compliance are relatively ineffective. The tax collectors generally have powers to waive or decrease penalties or there are other ways to avoid these after being applicable. While, the clarity and understandability in the procedures and the rules can be significantly improved, so far the system is quite dependent on personal human contact. Based on the above facts, a rating of 'C' is assessed for the dimension (i).

3.66 Taxpayer education is an important part of facilitating taxpayer compliance with registration, declaration and payment procedure. Actual and potential taxpayers need easy access to user-friendly, comprehensive and up-to-date information on the laws, regulations and procedures (e.g. posted on government websites, made available through taxpayer seminars, widely distributed guidelines/pamphlets and other taxpayer education measures). Potential taxpayers also need to be made aware of their liabilities thorough taxpayer education campaigns. However, the taxpayer education is very limited in the prevalent GoNWFP tax system.

3.67 In order to increase compliance and therefore the revenues, the taxpayers should be educated on the benefits of paying taxes, their rights and obligation as citizens, and how the collected revenues will be spent by the government for the taxpayers' benefits. Efforts have been made to reduce the weaknesses existing in the system but with limited success. Strong commitment from various levels is needed to remove this deficiency. The information needs to be organized in an objective and an easy-to-comprehend manner, supported by easy and cheaply accessible means to access the required data. In the present system, the taxpayers access the relevant tax information through booklets available in ordinary bookstores which often contain incomplete or outdated information; however, there are limited means of accessing the information electronically. The GoNWFP website also contains some general information about the revenue administration functions and the relevant levied taxes at all levels of the government. Considering these factors, dimension (ii) is rated 'B'.

3.68 The Excise & Taxation department is in the process of launching a web-based solution particularly for the property taxes. This will be a major forward looking step towards giving easy access to relevant information to the citizens and is bound to receive positive response and appreciation from the citizens and the other stakeholders. The NWFP Excise & Taxation Department has also implemented a Motor Vehicle Registration System. The Board of Revenue is planning to develop customized software for maintaining its processes. It would require a substantial effort and support from stakeholders at various levels to realize the gains from business process reengineering that can be supported by information technology.

3.69 Taxpayers' ability to contest decisions and assessment made by the revenue administration requires the existence of an effective complaints/appeals mechanism that guarantees the taxpayer a fair treatment. Although the tax appeals system of administrative procedures is operating in Excise & Taxation and Board of Revenue departments, it needs some redesign to be fair, transparent and effective. Therefore, dimension (iii) is rated 'C'.

3.70 Based on the above analysis of strengths and weaknesses of the prevalent revenue administration system, this PFM indicator is assigned an overall rating of "C+".

**P1-14 Effectiveness of measures for tax registration and assessment**

Overall rating 'C'

3.71 Effectiveness in tax assessment requires registration of liable taxpayers and correct assessment of tax liability for those taxpayers. Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration. Maintenance of taxpayer databases based on a unique taxpayer identification number is an important element of such a control system, and is most effective if linked with other government registration systems that involve elements of taxable turnover and assets (such as e.g. issue of business licenses).

3.72 The three dimensions assessed and their respective sub-rating are as follows:

- i) Controls in the taxpayer registration system – 'C'.
- ii) Effectiveness of penalties for non-compliance with registration and declaration obligations – 'C'.
- iii) Planning and monitoring of tax audit and fraud investigation programs – 'C'.

<b>Dimension</b>	<b>Minimum requirements for dimension score.</b>
(i) Controls in the taxpayer registration system.	Score = A: Taxpayers are registered in a complete database system with comprehensive direct linkages to other relevant government registration systems and financial sector regulations. Score = B: Taxpayers are registered in a complete database system with some linkages to other relevant government registration systems and financial sector regulations. Score = C: Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. Score = D: Taxpayer registration is not subject to any effective controls or enforcement systems
(ii) Effectiveness of penalties for non-compliance with registration and tax declaration	Score = A: Penalties for all areas of non-compliance are set sufficiently high to act as deterrence and are consistently administered. Score = B: Penalties for non-compliance exist for most relevant areas, but are not always effective due to insufficiently scale and/or inconsistent administration. Score = C: Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance. Score = D: Penalties for non-compliance are generally non-existent or ineffective (i.e. set far too low to have an impact or rarely imposed).

(iii) Planning and monitoring of tax audit programs.	<p>Score A: Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment.</p> <p>Score = B: Tax audits and fraud investigations are managed and reported on according to a documented audit plan, with clear risk assessment criteria for audits in at least one major tax area that applies self-assessment.</p> <p>Score = C: There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.</p> <p>Score = D: Tax audits and fraud investigations are undertaken on an ad hoc basis if at all.</p>
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3.73 In the current Board of Revenue (BoR) system, all the records are maintained on a manual basis with some reporting generated from excel files. No database system is in operation. In the case of the Excise and Taxation Department (E&T), a motor vehicle registration system is in place for the districts of Peshawar, Nowshera and Abbottabad. E&T is also in the process of launching a web based system for property taxes. However, for the most part, the present system is manual and is supported by excel-based reporting. The relatively less strong control environment in the current taxpayer registration system results in ineffective controls and enforcement; therefore, a rating of 'C' is appropriate for dimension (i).

3.74 Tax targets assessment process also needs to be streamlined. It has to be based on realistic assumptions and figures. All the relevant stakeholders should be involved in coming up with realistic targets based on the relevant ground realities. The entire process of assessment, collection and deposits to the treasury needs improvement. Lack of capacity is seen as one of the major factors for the weaknesses in the GoNWFP revenue system.

3.75 In the absence of a robust database management system, the present system is unable to effectively and efficiently maintain the taxpayer's records and assist the concerned officials in making informed and timely analysis regarding the taxpayers' profiles and payment histories. Dimension (ii) is therefore rated 'C'.

3.76 The ability to identify, investigate and successfully prosecute major evasion and fraud cases on a regular basis is essential for ensuring that taxpayers comply with their obligations. At present, the planning and monitoring of tax audit programs are non-existent, except for the basic process adopted by the external auditors (AGP), and the tax audits and fraud investigations are undertaken on an ad hoc basis, if at all. Both E&T and BoR lack capacity to plan and monitor tax audit programs. Although there are scope limitations on the work carried out by the Deputy Director (Revenue Audit Field) under the Director General Provincial Audit, the deficiency gap is somewhat narrowed. However, substantial improvement in the audit area is still required with heavy emphasis on automation and capacity building to more effectively and efficiently execute risk-based audit and fraud investigation programs. Therefore, the dimension (iii) is rated a 'C'.

3.77 Based on the above analysis, this indicator is assigned an overall "C" rating.

## **PI-15 Effectiveness in collection of tax payments**

Overall rating 'D+'

3.78 Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily or need close follow up.

3.79 The three assessed dimensions and their respective sub-ratings are as follows:

- i) The collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years) – ‘D’.
- ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration – ‘A’.
- iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury – ‘C’.

3.80 The following criteria are applied to determine the rating for each dimension:

Score	Minimum requirements
<b>A</b>	(i) The average debt collection ratio in the two most recent fiscal years was 90% or above OR the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections). (ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month.
<b>B</b>	(i) The average debt collection ratio in the two most recent fiscal years was 75-90% and the total amount of tax arrears is significant. (ii) Revenue collections are transferred to the Treasury at least weekly. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least quarterly within six weeks of end of quarter.
<b>C</b>	(i) The average debt collection ratio in the two most recent fiscal years was 60-75% and the total amount of tax arrears is significant (ii) Revenue collections are transferred to the Treasury at least monthly. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within 3 months of end of the year.
<b>D</b>	(i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections). (ii) Revenue collections are transferred to the Treasury less regularly than monthly (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay.

3.81 The White Paper for the FY2006-07-Budget of NWFP noted that provincial revenue receipts were badly affected due to low recoveries. The recovery of government dues by the BoR needs considerable improvement as evidenced through various audit reports. The cash based accounting system does not help as it does not focus on taxes that are collectable or payable. Above all, the arrears figures are not well-maintained, or at least management information with respect to arrears is not available. The factors mentioned have lead to a rating of ‘D’ assigned to dimension (i).

3.82 Prompt transfer of the collections to the Treasury is essential to avoid revenue suppression and for ensuring that the collected revenue is available to the Treasury for spending. This may take place either by having a system that obliges taxpayers to pay directly into accounts controlled by

the Treasury or, where the authority maintains its own collection accounts, by frequent and full transfers from those accounts to Treasury controlled accounts. In the case of GoNWFP, all receipts are deposited with the State Bank of Pakistan or the National Bank of Pakistan acting as its fiscal agent. However, in the cases where departments collect revenues, the timing of depositing the receipts to treasury needs considerable improvement; as evidenced from the audit reports of the AGP. There had been rare cases where the government revenues were unlawfully retained and not credited to the treasury. The same practices are also found in public hospitals that generate some revenues. Nonetheless, the overall impact of these delays in receipts from service delivery institutions on the collection of total revenues is negligible. Therefore, dimension (ii) is rated 'A'.

3.83 In a properly functioning tax collection system with effective and efficient controls in place, aggregate reporting on tax assessments, collections of arrears and transfers to (and receipts by) the Treasury must take place regularly and be reconciled, where appropriate. This ensures that the collection system functions as intended, tax arrears are monitored and the revenue float is minimized. GoNWFP tax assessment and collection systems are weak in this area. In order to reconcile the figures, the amounts must be deposited on time. Although efforts to reconcile the figures are made periodically, it is difficult to perform complete reconciliations of tax assessments, collections and transfers to Treasury as there are no integrated IT interfaces between assessments, payments and accounting, and the banking system. On the basis of the above evidence, therefore, dimension (iii) is rated 'C'.

3.84 Following the application of the weakest link - M1 scoring methodology - the indicator is assessed as "D+".

#### **PI-16 Predictability of available funds for expenditure commitments**

Overall rating 'C+'

3.85 Effective execution of the budget, in accordance with the work plans, requires that the spending departments and agencies receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the department of finance provides reliable information on the availability of funds to spending departments. To be reliable, the amount of funds made available to an entity for a specific period should not be reduced during that period.

3.86 Predictability for departments in the availability of funds is facilitated by effective cash flow planning, monitoring and management by the Treasury, based on regular and reliable forecasts of cash inflows and of major outflows which are linked to the budget implementation and commitment plans for individual department.

3.87 This indicator of the PFM Framework looks for a cash flow forecast mechanism to be in place, reliable information regarding ceilings for expenditure commitment to be provided to departments and adjustment to the allocations to be done in a predictable and transparent way.

3.88 The three dimensions assessed and their respective sub-ratings are given below:

- i) Extent to which cash flows are forecasted and monitored – 'C'.
- ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment – 'A'.
- iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs – 'B'.

3.89 The following table describes the rating criteria:

Score	Minimum requirements
<b>A</b>	(i) A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows. (ii) MDAs' are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.
<b>B</b>	(i) A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows. (ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a fairly transparent way.
<b>C</b>	(i) A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated. (ii) MDAs are provided reliable information for one or two months in advance. (iii) Significant in-year budget adjustments are frequent, but undertaken with some transparency.
<b>D</b>	(i) Cash flow planning and monitoring are not undertaken or of very poor quality. (ii) MDAs are provided commitment ceilings for less than a month OR no reliable indication at all of actual resource availability for commitment. (iii) Significant in-year budget adjustments are frequent and not done in a transparent manner.

3.90 In the case of NWFP, the spending departments have considerable autonomy in planning and committing expenditures in accordance with the original budget when viewed at the level of the Principal Accounting Officer/Administrative Secretary. The practice at NWFP is that the whole year's budget in case of recurrent expenditures (i.e. salary, utilities etc.) is released by the FD at the start of the fiscal year. Similarly most of the annual development program for approved schemes is released at the start of the fiscal year. The lump sum provision and fixed assets expenditure / durable goods are released on a case-by-case basis with the approval of the Finance Secretary. These release policies for the year are intimated, in writing, to all spending departments. It is then at the discretion of the PAOs or the Budget Drawing and Disbursement Officers to release their respective budgets to their sub-ordinate formations/spending units (Spending Drawing and Disbursement Officers). Considering the budget as annual forecast of cash inflows and outflows, cash availability information is fully known at the beginning of the year; however, it is not updated during the year. Thus, dimension (i) is rated 'C'. Since funds releases are timely and front-loaded, timing of entering into commitments rests with the spending departments. As a result, dimension (ii) is rated 'A'. The departments have sufficient powers of re-appropriation, thus providing the management flexibility. During the year, adjustments to allocations in the light of unanticipated events affecting the revenues or expenditure are informed to the spending departments; hence dimension (iii) is rated 'B'.

3.91 Applying M1 methodology for arriving at overall rating for the indicator, PI-16 is assessed as "C+".

### **PI-17 Recording and management of cash balances, debt and guarantees**

Overall rating 'B+'

3.92 Debt management, in terms of contracting, servicing and repayment, and the provision of government guarantees are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt service costs and can create significant

fiscal risk. The maintenance of a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments, and well planned debt roll-over. An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated. Critical to debt management performance are also the proper recording and reporting of government issued guarantees and the approval of all guarantees by a single government entity (e.g. the department of finance or a debt management commission) against adequate and transparent criteria.

3.93 The three dimensions assessed and their respective sub-ratings are as follows:

- i) Quality of debt data recording and reporting – ‘B’.
- ii) Extent of consolidation of the government’s cash balances – ‘B’.
- iii) Systems for contracting loans and issuance of guarantees – ‘A’.

3.94 The exact criteria for assessing each dimension within the indicator are given below:

<b>Dimension</b>	<b>Minimum requirements for dimension score.</b>
(i) Quality of debt data recording and reporting	<p><b>Score = A:</b> Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly</p> <p><b>Score = B:</b> Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually.</p> <p><b>Score = C:</b> Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content.</p> <p><b>Score = D:</b> Debt data records are incomplete and inaccurate to a significant degree.</p>
(ii) Extent of consolidation of the government’s cash balances	<p><b>Score = A:</b> All cash balances are calculated daily and consolidated.</p> <p><b>Score = B:</b> Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement.</p> <p><b>Score = C:</b> Calculation and consolidation of most government cash balances take place at least monthly, but the system used does not allow consolidation of bank balances</p> <p><b>Score = D:</b> Calculation of balances takes place irregularly, if at all, and the system used does not allow consolidation of bank balances.</p>
(iii) Systems for contracting loans and issuance of guarantees.	<p><b>Score = A:</b> Central government’s contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.</p>

	<p><b>Score = B:</b> Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.</p> <p><b>Score = C:</b> Central government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings.</p> <p><b>Score = D:</b> Central government's contracting of loans and issuance of guarantees are approved by different government entities, without a unified overview mechanism.</p>
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3.95 NWFP maintains a manual recording system of debts (both domestic and foreign) which is gathered from various sources and maintained in a spreadsheet form. The Budget White paper contains a list of all loans.

3.96 The Finance Department reconciles the domestic (federal) loans with the Federal Finance Division, Islamabad, on a yearly basis, while the foreign loans, once confirmed from the Project Executing Agencies, are reconciled with the Economic Affairs Division, Islamabad. Similarly, records for the deferred liabilities like pensions and GP Fund are maintained on manual basis and are not subject to actuarial valuation. There are no other market loans or government guarantees outstanding, and by FY2000 all such guarantees were either paid off or retired. Therefore, dimension (i) is rated 'B'.

3.97 As mentioned above, GoNWFP maintains its bank accounts i.e. both Consolidated Fund and Public Account through government account # 1. In addition, separate bank accounts for District Government Funds (# 4) and Zakat Funds (# 3) are also maintained. A daily fax is received by the Finance Department from the SBP head office, Karachi, which reports account balances for each of these government bank accounts. FD prepares a daily comparison of balances and identifies any large and unusual items. Copies of daily Bank balances are sent to concerned higher officials for cash management and decision making purposes, although there always exists material differences between the fiscal balances as per the books of the Accountant General and the monetary balances as per the bank statements from the SBP. NWFP is not alone in this as this affects all provinces in Pakistan. Thus, dimension (ii) is rated 'B'.

3.98 The government has also formulated a provincial "Debt Management Strategy" with the objective of creating more fiscal space through premature retirement of remaining Cash Development Loans (CDLs) (worth Rs. 23.6 billion by end FY05-06) and/or renegotiating the terms of the existing loans with the federal government. As a measure of fiscal discipline, all debts are approved by the Planning and Development Department. The government has already retired Rs. 10.1 billion worth of expensive loans during FY03-05, thereby creating a cumulative fiscal space of Rs. 1.9 billion. Due to the foregoing, dimension (iii) is rated 'A'.

3.99 In summary, a rating of "B+" is assessed for the indicator consistent with the PFM scoring methodology (M2).

**PI-18 Effectiveness of payroll controls**

Overall rating 'B+'

3.100 The wage bill is usually one of the biggest items of government expenditure and susceptible to weak control and corruption. The link between the personnel database and the payroll is a key control. Any amendments required to the personnel database should be processed in a timely manner through a change report, and should result in an audit trail, payroll audits

should be undertaken regularly to identify any ghost workers, fill data gaps and identify control weaknesses.

3.101 The four dimensions assessed and their respective sub-ratings as below:

- i) Degree of integration and reconciliation between personnel records and payroll data – ‘B’.
- ii) Timeliness of changes to personnel records and the payroll – ‘A’.
- iii) Internal controls over changes to personnel records and the payroll – ‘B’.
- iv) Existence of payroll audits to identify control weaknesses and/or ghost workers – ‘A’.

Score	Minimum requirements
<b>A</b>	<ul style="list-style-type: none"> <li>(i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation.</li> <li>(ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the following month’s payments. Retroactive adjustments are rare (if reliable data exists, it shows corrections in max. 3% of salary payments).</li> <li>(iii) Authority to change records and payroll is restricted and results in an audit trail.</li> <li>(iv) A strong system of annual payroll audits exists to identify control weaknesses and/or ghost workers.</li> </ul>
<b>B</b>	<ul style="list-style-type: none"> <li>(i) Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month’s payroll data.</li> <li>(ii) Up to three months’ delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally.</li> <li>(iii) Authority and basis for changes to personnel records and the payroll are clear.</li> <li>(iv) A payroll audit covering all central government entities has been conducted at least once in the last three years (whether in stages or as one single exercise).</li> </ul>
<b>C</b>	<ul style="list-style-type: none"> <li>(i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months.</li> <li>(ii) Up to three months delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments.</li> <li>(iii) Controls exist, but are not adequate to ensure full integrity of data.</li> <li>(iv) Partial payroll audits or staff surveys have been undertaken within the last 3 years.</li> </ul>
<b>D</b>	<ul style="list-style-type: none"> <li>(i) Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists.</li> <li>(ii) Delays in processing changes to payroll and nominal roll are often significantly longer than three months and require widespread retroactive adjustments.</li> <li>(iii) Controls of changes to records are deficient and facilitate payment errors.</li> <li>(iv) No payroll audits have been undertaken within the last three years.</li> </ul>

3.102 In GoNWFP, the change control mechanism in the payroll system is very strong. Any change must go through checks at different levels, ensuring high integrity of the data and the

system. All changes are reconciled promptly, generally in time for the following month's payroll data. A strong system of internal controls also exists along with a timely internal audit review which further strengthens the payroll system. Payroll is based on personnel records using a computer system although the personnel records (HRMIS) are not directly linked to payroll processing. The FD maintains a HRMIS but this is not integrated with the payroll processing module in SAP/R3 that is managed and controlled by the Accountant General. Therefore, keeping in view such robust system of timely change controls on payroll data, and the fact that personnel records, though maintained, are not electronically linked to the payrolls themselves, dimensions (i) and (ii) are rated 'B' and 'A' respectively.

3.103 Incomplete changes request forms (source forms) in any material aspect are not accepted. Transfer cases from the computerized districts must be supported by a computer-issued pay slip for last month duly signed by the DDO and counter-signed by the concerned DAO. Bank-related changes must bear the DDO's signatures and office stamp of concerned department. The TR number also needs to be duly verified by the Assistant Audit Officer (AAO) of that payroll section. The final processing of the monthly payroll is done around 21<sup>st</sup> of each month. No changes are accepted after that day and are carried forward to be implemented the next period. A strong audit trail mechanism exists to capture the changes in the manual as well as in the computerized processes but in the absence of an integrated HRMIS module and payroll processing module, and the fact that the amendment of the personnel data that feed into the payroll is controlled by the same entity (office of the Accountant General), internal control weakness emerge. Thus, dimension (iii) is rated 'B'.

3.104 Since payroll expenditure is the major portion of the recurrent budget (about 75%), another level of check is imposed on the system through the budgeting process. Every department/office is required to submit a statement providing its estimated payroll cost for the coming year using FORM BM-6. This process also becomes part of the monitoring mechanism to eliminate any weaknesses.

3.105 In addition, a specialized team of four auditors, working under the supervision of Additional Auditor General, performs monthly audits of the payroll system. Also, a Cell is established in the office of the Accountant general to pre- and post-audit payroll transactions in the province. Hence, based on the existence and effective operation of above-mentioned controls, dimension (iv) is rated 'A'.

3.106 Therefore, the overall rating for the indicator is assessed "A".

## **PI-19 Competition, value for money and controls in procurement**

Overall rating 'C'

3.107 Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for and value for money in delivery of programs and services by the government. This PFM framework element focuses on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method and defines the alternatives to open competition that may be appropriate when justified in specific, defined situations. An overall strong control environment of the PFM systems benefits the procurement system to a large extent. Effective and efficient internal controls in the implementing agencies, complemented by the checks through external audits, could greatly enhance agencies' transparency and accountability in the procurement process. A good procurement system actively involves all the relevant stakeholders in the process. As part of the control system, it involves the stakeholders by establishing a clear regulated process that enables the submission and timely resolution of complaints submitted by private sector participants. The rules are overridden only when justified. There is regular advertisement of opportunities and

publication of data on public contracts. There are few unexplained delays in awarding contracts and in making payment. The system provides for timely feedback of cost data and execution against plans to support the PFM process.

3.108 Three dimensions have been assessed, and their respective sub-ratings are provided below:

- i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold) – ‘C’.
- ii) Extent of justification for use of less competitive procurement methods – ‘C’.
- iii) Existence and operation of a procurement complaints mechanism – ‘C’.

3.109 The criteria for assessment of each dimension are given below:

<b>Dimension</b>	<b>Minimum requirements for dimension score.</b>
(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	Score = A: Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition. Score = B: Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate. Score = C: Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate. Score = D: Insufficient data exists to assess the method used to award public contracts OR the available data indicates that use of open competition is limited.
(ii) Justification for use of less competitive procurement methods	Score = A: Other less competitive methods when used are justified in accordance with clear regulatory requirements. Score = B: Other less competitive methods when used are justified in accordance with regulatory requirements. Score = C: Justification for use of less competitive methods is weak or missing. Score = D: Regulatory requirements do not clearly establish open competition as the preferred method of procurement.
(iii) Existence and operation of a procurement complaints mechanism	Score = A: A process (defined by legislation) for submission and timely resolution of procurement process complaints is operative and subject to oversight of an external body with data on resolution of complaints accessible to public scrutiny. Score = B: A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority. Score = C: A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints. Score = D: No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process.

3.110 In NWFP, procurement procedures and their implementation need review in order to be made more transparent and less bureaucratic. The Auditor General's (AGP) district audits reports for FY 2002-03, in particular, pointed out that for the tendering process, proper contract execution and contract management were found lacking, resulting in loss to the exchequer. This was specially the case in respect of the Works & Services Department. Similarly, the GoNWFP's FY2003-04 audit report contains observations relating to mismanaged procurements of goods and services. Therefore, the evidence suggests that there are issues existing in the complete compliance with the procurement rules and regulations. Nonetheless, the executives are by and large cognizant of the defects in the rules and regulations and do advertise for competitive bidding. For dimension (i), a score of 'C' is applied because current indications are that although insufficient data exist to assess the exact compliance with procurement rules and regulations relating to award of public contracts, there is anecdotal evidence to support the fact that competitive bidding is pursued in most cases.

3.111 GoNWFP pioneered the introduction of the Procurement Ordinance in 2002. Continuing with its leadership in procurement reforms, it passed a new Procurement Law for goods, works and services in 2003. Despite this law, procedures and practices continue to obstruct best practice in the selection of contractors and the procurement of goods and services. Most implementing agencies have not fully adopted the new procedures in their operations with the result that most procurements are still being done using the old set of directives, notifications and manuals. The reason for inaction in implementation seems to be lack of awareness and ownership of the law, slack enforcement, and limited capacity to implement the law. Hence, in spite of the progress made, further work is needed to make it effective and ensure its implementation.

3.112 To ensure transparency and competitiveness, the government needs to align this law with international best practice and ensure the enforcement of the law and apply Standard Bidding Documents in all public procurement. Rules for procuring services and recruitment of consultants also need to be made more specific and in line with international best practice. It is noted that the GoNWFP has initiated a procurement reform process with the support of the World Bank through an IDF Grant approved for this purpose. For dimension (ii), a score of 'C' is applied because the justification for use of less competitive methods is weak or missing.

3.113 For dimension (iii), a score of 'C' is assigned because, while a process exists for submitting and addressing procurement complaints, it is designed poorly and does not operate in a manner that provides for timely resolution of complaints; invariably, aggrieved bidders do resort, in some cases, to legal recourse.

3.114 Based on the current procurement system conditions, this PFM indicator is assigned an overall "C" rating. A separate exercise based on the OECD/DAC assessment framework has been carried out to assess, in considerable detail, the performance of procurement systems against a set of 12 indicators.

## **PI-20 Effectiveness of internal controls for non-salary expenditure**

Overall rating 'C+'

3.115 The PFM Framework looks for an internal control system that is relevant, and incorporates a comprehensive and generally cost effective set of controls, which are widely understood. It looks for a high compliance rate with rules, rarely bypassed controls, and a top management that takes clear and full responsibility for the effective operation of the system.

3.116 The three assessed dimensions and their respective sub-ratings are as below:

- i) Effectiveness of expenditure commitment controls – 'B'.

- ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures – ‘B’.
- iii) Degree of compliance with rules for processing and recording transactions – ‘C’.

3.117 The detailed criteria for the assessment of individual dimensions involved of the indicator are given in the following table:

Score	Minimum requirements
<b>A</b>	(i) Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised). (ii) Other internal control rules and procedures are relevant, incorporates a comprehensive and generally cost effective set of controls, which are widely understood. (iii) Compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant.
<b>B</b>	(i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception. (ii) Other internal control rules and procedures incorporate a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g. through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays. (iii) Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification.
<b>C</b>	(i) Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated. (ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance. (iii) Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern.
<b>D</b>	(i) Commitment control systems are generally lacking OR they are routinely violated. (ii) Clear, comprehensive control rules/procedures are lacking in other important areas. (iii) The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified/emergency procedures.

3.118 A strong system of budgetary control is exercised through maintenance of budget appropriation registers by the Accountant General and District Accounts Officers. Exceptions rarely happen and reported by the audit offices. However, since registers are manual and do not exclude over-riding the appropriation limits in terms of payments against individual heads, the dimension (i) is rated 'B'.

3.119 Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. A pre-audit function is in place but the function, sometimes, apply very rigorous rules which are excessive and not supportive of timely service delivery. Therefore, dimension (ii) is also rated 'B'.

3.120 Rules are complied in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern. Analysis of recent audit reports at both district and provincial level reveals that control has been missing, at times, thus leading to financial and operational irregularities. However, the external audit was able to detect these irregularities and corrective actions are generally pursued in due course.

3.121 The internal control procedures contained in such rules and regulations are not generally understood and, sometimes, have multiple interpretations, which ultimately provide undue discretion to government functionaries. This, coupled with the general lack of capacity required for implementation of the rules relating to financial and contract management, leads to the conclusion that there is an immediate need for capacity building programs, including refresher courses, for the executives / DDOs. Thus, based on the existing state of affairs, dimension (iii) is rated 'C'.

3.122 Following the M1 scoring methodology for assessing the composite rating, the overall rating for the indicator is "C+".

**PI-21 Effectiveness of internal audit**

Overall rating 'D'

3.123 The PFM Framework expects an effective internal audit function to be in operation. An appropriately structured and skilled internal audit function provides regular and adequate feedback to management on the performance of the internal control system. An effective and efficient internal audit function must have certified staff, adequate independence, broad mandate, and sufficient power to report. It must adhere to appropriate professional standards. It should be focused on reporting significant systemic issues in relation to: reliability and integrity of financial and operational information; effectiveness and efficiency of operation; safeguarding of assets; compliance with laws, regulations, contracts, etc.

3.124 The assessment criteria for scoring the effectiveness of the internal audit function are given in the following table:

Score	Minimum requirements
A	(i) Internal audit is operational for all provincial government entities, and generally meet professional standards, It is focused on systemic issues (at least 50% of staff time). (ii) Reports adhere to a fixed schedule and are distributed to the audited entity, ministry of finance and the SAI. (iii) Action by management on internal audit findings is prompt and comprehensive across provincial government entities.
B	(i) Internal audit is operational for the majority of provincial government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time). (ii) Reports are issued regularly for most audited entities are distributed to the audited entity, the ministry of finance and the SAI. (iii) Prompt and comprehensive action is taken by many (but not all) managers.
C	(i) The function is operational for at least the most important provincial government entities and undertakes some systems review (at least 20% of staff time), but may not meet recognized professional standards. (ii) Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the SAI. (iii) A fair degree of action taken by many managers on major issues but often with delay

D	(i) There is little or no internal audit focused on systems monitoring. (ii) Reports are either non-existent or very irregular. (iii) Internal audit recommendations are usually ignored (with few exceptions).
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3.125 The internal audit function in the GoNWFP departments has become non-existent over the years despite the existence of the pre-audit at DAOs and the increasing dominance of Local Fund Auditors at local government levels. GoNWFP is the only province however that notified the establishment of internal audit functions in all its 19 line departments in FY2004-05. Although some positive strides have been made at the provincial level in attempting to implement internal auditing practices and systems, the basis of their establishment has proved to be faulty and ineffective. Most of the staff assigned as internal auditors are neither certified nor have the basic capacity to carry out systemic reviews, using contemporary tools, techniques, and necessary technologies, as required by the Institute of internal Auditors (IIA). This has thus affected the whole framework of internal controls and the financial accountability system.

3.126 Specific evidence of an effective internal audit function would also include: assessment and monitoring of error rates in procurement and expenditure transactions, a focus on high risk areas, reporting on correction rates, use of internal audit reports by the AGP, and follow-up corrective actions taken by management in response to the internal audit findings. The most recent external audit reports on provincial and district governments also confirm that a functional internal audit function does not exist in GoNWFP.

3.127 This indicator’s assessment is based on the coverage and quality of internal audit function, frequency and distribution of reports and extent of management response to internal audit findings. Since all of the above dimensions are missing in the current system, a rating of 'D' is justified for each dimension as well as a 'D' for the overall indicator.

**PI-22 Timeliness and regularity of accounts reconciliation**

Overall rating ‘B’

3.128 The PFM Framework looks for high quality bank reconciliation at aggregated and detailed levels at least monthly, with very little backlog, suspense accounts routinely reconciled and cleared quarterly, and advances accounts forward balance.

3.129 The two dimensions assessed and their respective sub-ratings are as follows:

- i) Regularity of bank reconciliations – ‘B’.
- ii) Regularity of reconciliation and clearance of suspense accounts and advances – ‘B’.

3.130 The evaluation criteria are:

Dimension	Minimum requirements for dimension score.
(i) Regularity of bank reconciliations	<p><b>Score = A:</b> Bank reconciliation for all central government bank accounts take place at least monthly at aggregate and detailed levels, usually within 4 weeks of end of period.</p> <p><b>Score = B:</b> Bank reconciliation for all Treasury managed bank accounts take place at least monthly, usually within 4 weeks from end of month.</p> <p><b>Score = C:</b> Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter.</p> <p><b>Score = D:</b> Bank reconciliation for all Treasury managed bank accounts take place less frequently than quarterly OR with</p>

	backlogs of several months.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	<p><b>Score = A:</b> Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward.</p> <p><b>Score = B:</b> Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period. Some accounts have uncleared balances brought forward.</p> <p><b>Score = C:</b> Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year, but a significant number of accounts have uncleared balances brought forward.</p> <p><b>Score = D:</b> Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months' delay, OR less frequently.</p>

3.131 The accounting system in Pakistan is undergoing major reforms supported by PIFRA in the shape of implementation of NAM in an automated (SAP R/3) environment, and NWFP is the first province to achieve full productivity with all districts having migrated on-line in December 2006. The treasury-managed bank accounts are reconciled monthly within 13 days of month end. However, major irreconcilable differences do arise between the monetary balances (as per the SBP) and the fiscal balances (AG booked revenues and expenditures). As a result, dimension (i) is rated 'B'.

3.132 Accounts are also separately maintained in departments by aggregating district level data. A reconciliation process is conducted between each DAO and spending DDO on a monthly basis, and at an aggregate level between the Accountant General's Office and the departments' PAO. The figures for reconciliation in NWFP remained satisfactory over the past few years (above 96% for receipts, expenditures, inter-governmental accounts, and suspense accounts) and these are likely to improve with the implementation of computerized accounting systems. The latest published Finance Accounts for the year FY2002-2003 show an un-reconciled difference (Suspense) of Rs. 273 millions. Clearance of suspense accounts and advances takes place annually during the finalization of the draft finance accounts. Therefore, dimension (ii) is rated 'B'.

3.133 Based on the above, the scoring methodology for the indicator shows an overall rating of 'B'.

### **PI-23 Information on resources received by service delivery units**

Overall rating 'B'

3.134 The PFM framework looks for quality information to be provided to front line service delivery units providing services at the community level (such as schools and health clinics) on resources that are intended for their use. Frontline service delivery units being furthest in the resource allocation chain, may be the ones to suffer most when overall resource fall short of budget estimates or when higher level organizational units decide to re-direct funds to other purposes. There may be significant delays in transfer of resources to the unit whether in cash or in kind. Tracking of such information is crucial in order to determine, if the PFM systems affectively support frontline service delivery. The evaluation criteria are objectively stated in the table given below:

<b>Score</b>	<b>Minimum requirements (Scoring methodology)</b>
<b>A</b>	(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The

	information is compiled into reports at least annually.
<b>B</b>	(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics across most of the country with information compiled into reports at least annually; OR special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by both primary schools and primary health clinics across most of the country (including by representative sampling).
<b>C</b>	(i) Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country OR by primary service delivery units at local community level in several other sectors.
<b>D</b>	(i) No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.

3.135 With the PIFRA SAP/R3 system rolled-out to all districts in NWFP, resource transfers to service delivery units as well as their reporting at the lowest expenditure line items have now become possible. The reports could be generated at the levels of budget and expenditure DDO levels too, and this covers both primary schools and primary health clinics as they are recognized as DDOs. While the reports are generally reliable, they are rarely being used as tracking tools at the moment. These service delivery units also have their own memorandum information systems (some are manual) that are outside the overall accounting system. As the reports are compiled for most of the units at least annually by budget time, the indicator is rated ‘B’.

#### **P1-24 Quality and timeliness of in-year budget reports**

Overall rating ‘C+’

3.136 An effective budget execution requires timely and regular information on actual budget performance to be available both to the ministry of finance (and cabinet), to monitor performance and if necessary to identify new action to get the budget back and track and to the Ministries, Departments, Agencies (MDA) for managing the affairs for which they are accountable. This indicator focuses on the ability to produce comprehensive reports from the accounting system on all aspects of the budget.

3.137 The three dimensions assessed and their sub-ratings are provided below:

- i) Scope of reports in terms of coverage and compatibility with budget estimates – ‘C’.
- ii) Timeliness of the issue of reports – ‘A’.
- iii) Quality of information – ‘C’.

3.138 The assessment criteria are summarized in the table below:

<b>Score</b>	<b>Minimum requirements</b>
<b>A</b>	(i) Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period. (iii) There are no material concerns regarding data accuracy.
<b>B</b>	(i) Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly, and issued within 6 weeks of end of

	<p>quarter.</p> <p>(iii) There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/usefulness.</p>
<b>C</b>	<p>(i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both).</p> <p>(ii) Reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks of end of quarter.</p> <p>(iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.</p>
<b>D</b>	<p>(i) Comparison to the budget may not be possible across all main administrative headings.</p> <p>(ii) Quarterly reports are either not prepared or often issued with more than 8 weeks delay.</p> <p>(iii) Data is too inaccurate to be of any real use.</p>

3.139 The PFM Framework looks for reliable budget reports, with classifications that allows direct comparison to the budget and incorporate expenditure, revenue and debt information that are disseminated within government within four weeks of month and quarter end. The Accountant General at the provincial level and DAO at the district level prepare monthly civil accounts according to the budget chart of accounts and provide these to the Finance Department within 15-21 days after the end of each month. Currently, the in-year accounts are only provided to the Finance Department / EDO(F&P), and the individual departments are not provided with their respective statements. The actual figures are not compared with the budgeted amounts to reflect variances and commitment accounting is not yet in use. Similarly, the reports are generated by functions and not on the detailed heads of account, including their economic classifications. There are also some concerns on accuracy of data due to existence of un-reconciled transactions and the quality of information received from DAOs, being merely abstracts of expenditure, is yet to be of high standard. However, with PIFRA systems having now rolled-out across the province, the reports can now be generated at the detailed object levels as well and the level of accuracy, subject to classification errors, is now enhanced. Based on the information above, dimension (i) is rated 'C', dimension (ii) is rated 'A', and dimension (iii) is rated 'C'.

3.140 Based on the scope of reports in terms of coverage and compatibility with budget estimates, timeliness of issue of reports and quality of information, a rating of 'B' is assigned to this indicator.

## **PI-25 Quality and timelines of annual financial statements**

Overall rating 'B'

3.141 Consolidated year end financial statements are critical for transparency in the PFM system. To be complete, they must be based on details for all independent departments and de-concentrated units. In addition, the ability to prepare year end financial statements in a timely fashion is a key indicator on how well the accounting system is operating, and the quality of records maintained. In order to be useful and to contribute to transparency, financial statements must be understandable to the reader, and deal with transactions, assets and liabilities in a transparent and consistent manner. This is the purposes of financial reporting standards. Some countries have their own public sector financial reporting standards, set by government or other authorized body. To be generally acceptable, such national standards are usually aligned with international standards such as the International Public Sector Accounting Standard (IPSAS).

3.142 The three dimensions assessed have the following respective sub-ratings:

- i) Completeness of the financial statements – ‘B’.
- ii) Timeliness of submission of the financial statements – ‘B’.
- iii) Accounting standards used – ‘B’.

3.143 The assessment criteria are given below:

Score	Minimum requirements
<b>A</b>	(i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities. (ii) The statement is submitted for external audit within 6 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied for all statements.
<b>B</b>	(i) A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities (ii) The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied.
<b>C</b>	(i) A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant. (ii) The statements are submitted for external audit within 15 months of the end of the fiscal year. (iii) Statements are presented in consistent format over time with some disclosure of accounting standards.
<b>D</b>	(i) A consolidated government statement is not prepared annually, OR essential information is missing from the financial statements OR the financial records are too poor to enable audit. (ii) If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year (iii) Statements are not presented in a consistent format over time or accounting standards are not disclosed.

3.144 For dimension (i), A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities. A rating of ‘B’ is therefore assigned to this dimension.

3.145 For dimension (ii), the financial statements are provided to audit more than 6 months but less than 10 months after the end of the year. A rating of ‘B’ is applicable to the dimension.

3.146 For dimension (iii), statements are presented in a consistent format over time with some disclosure of accounting standards. The International Public Sector Accounting Standards (IPSAS) are not applied although the AGP has now notified the adoption of the Standard and in particular, the IPSAS 2 reporting format that shall apply as of FY 2007-08 accounts. Government national standards – cash basis – are applied. On the basis of the above, a rating of ‘B’ is assigned to this dimension.

3.147 On an overall basis, a rating of ‘B’ is assigned to the indicator.

## **PI-26 Scope, nature and follow-up of external audit**

Overall rating 'D+'

3.148 A high quality external audit is an essential requirement for creating transparency in the use of public funds. Key elements of the quality of actual external audit comprise the scope/coverage of the audit, adherence to appropriate auditing standards including independence of the external audit institution (ref. INTOSAI and IFAC/IAASB), focus on significant and systemic PFM issues in its reports, and performance of the full range of financial audit such as reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems. Inclusion of some aspects of performance audit (such as e.g. value for money in major infrastructure contracts) would also be expected of a high quality audit function.

3.149 The scope of audit mandate should include extra-budgetary funds and autonomous agencies. The latter may not always be audited by the Supreme Audit Institution (SAI), as the use of other audit institutions may be foreseen. The scope indicates the entities and sources of funds that are audited in any given year. Where SAI capacity is limited, the audit program may be planned by the SAI in line with legal audit obligations on a multi-year basis in order to ensure that most important or risk-prone entities and functions are covered annually, whereas other entities and functions may be covered less frequently.

3.150 The three dimensions assessed and their respective sub-ratings as follows:

- i) Scope/nature of audit performed (including adherence to auditing standards) – 'B'.
- ii) - Timeliness of submission of audit reports to legislature - 'D'.
- iii) - Evidence of follow up on audit recommendations – 'C'.

3.151 For dimension (i) - the Auditor General Ordinance 2001 explains the constitutional mandate of the Auditor General of Pakistan whereby he is responsible for auditing all government formations and government enterprises (the latter where they are 50% plus funded by the government). PIFRA has updated auditing methods and a district audit function has been established since 2004. As all entities of the provincial and district governments are audited annually, a full range of financial audits and some aspects of performance audit are performed. Since *some* of the audit formations already began using the Financial Audit Manual (2005) that is generally compliant with international auditing standards as basis for their audits, a rating of 'B' applies for this dimension under the 'new audit methodology'. The rating would ordinarily have been 'A' if coverage, using the Financial Audit Manual included all government formations and enterprises which is not the case at the moment.

3.152 For dimension (ii) - the audit reports for the provincial and district governments for FY 2002-03 to FY 2004-05, already completed within 5 months of receipt of the financial statements, have been delayed by no less than 12 months before they were presented to the legislature. The situation is worse at the district level as the 2003-04 accounts which were already audited have still yet to be presented to the *Zila* Councils. As the latest audit reports for the entire province (FY 2004-05) have, for more than 12 months, not been presented to the legislature after receipt of the financial statements, a rating of 'D' applies for this dimension.

3.153 For dimension (iii) - the Public Accounts Committees are reviewing and reporting on the outstanding audit reports for previous years and there is increasingly substantial departmental follow up of audit observations. The PAC is currently reviewing the audit reports and audited accounts for year 2002-03 and their final report has been presented to the provincial assembly. As the PAC has now engaged in a practice of referring less serious audit issues back to the DACs for their review and necessary action, this is facilitating the improvement in the pace and quality of

follow-up of audit issues since a substantial backlog (over 11 years) remains yet to be reviewed by the PAC itself. On the basis of this, a rating of ‘C’ is assigned to this dimension.

3.154 Overall, therefore, the indicator scores a rating of ‘D+’.

3.155 The assessment criteria used are given in the table below:

<b>Score</b>	<b>Minimum requirements</b>
<b>A</b>	(i) All entities of provincial government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues. (ii) Audit reports are submitted to the legislature within 4 months of the end of the period covered and in the case of financial statements from their receipt by the audit office. (iii) There is clear evidence of effective and timely follow up.
<b>B</b>	(i) Provincial government entities representing at least 75% of total expenditures <sup>12</sup> are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues. (ii) Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office. (iii) A formal response is made in a timely manner, but there is little evidence of systematic follow up.
<b>C</b>	(i) Provincial government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only. (ii) Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements from their receipt by the auditors). (iii) A formal response is made, though delayed or not very thorough. but there is little evidence of any follow up.
<b>D</b>	(i) Audits cover provincial government entities representing less than 75% of total expenditures or audits have higher coverage but do not highlight the significant issues. (ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors). (iii) There is little evidence of response or follow up.

### **PI-27 Legislative scrutiny of the annual budget law**

Overall rating ‘C+’

3.156 The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate and the time allowed for that process. The PFM Framework, therefore, looks for legislative scrutiny to be comprehensive, well-informed by summary and detailed information, and involve in-depth review by specialized committees. The legislature should have at least two months to review the budget proposals and there should be

clear rules for in-year budget amendments by the Executive, and strict limits that are consistently respected on the extent and nature of amendments.

3.157 The four dimensions assessed, and their respective sub-ratings are as follows:

- i) Scope of the legislature’s scrutiny – ‘A’.
- ii) Extent to which the legislature’s procedures are well-established and respected – ‘B’.
- iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined) – ‘C’.
- iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature – ‘B’.

3.158 The criteria for assigning ratings to these dimensions are given in the table below:

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	<ul style="list-style-type: none"> <li>(i) The legislature’s review covers fiscal policies, medium term fiscal framework and medium term priorities as well as details of expenditure and revenue.</li> <li>(ii) The legislature’s procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures.</li> <li>(iii) The legislature has at least two months to review the budget proposals.</li> <li>(iv) Clear rules exist for in-year budget amendments by the executive, set strict limits on extent and nature of amendments and are consistently respected.</li> </ul>
<b>B</b>	<ul style="list-style-type: none"> <li>(i) The legislature’s review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue.</li> <li>(ii) Simple procedures exist for the legislature’s budget review and are respected.</li> <li>(iii) The legislature has at least one month to review the budget proposals.</li> <li>(iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.</li> </ul>
<b>C</b>	<ul style="list-style-type: none"> <li>(i) The legislature’s review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized.</li> <li>(ii) Some procedures exist for the legislature’s budget review, but they are not comprehensive and only partially respected.</li> <li>(iii) The legislature has at least one month to review the budget proposals.</li> <li>(iv) Clear rules exist, but they may not always be respected OR they may allow extensive administrative reallocation as well as expansion of total expenditure.</li> </ul>
<b>D</b>	<ul style="list-style-type: none"> <li>(i) The legislature’s review is non-existent or extremely limited, OR there is no functioning legislature.</li> <li>(ii) Procedures for the legislature’s review are non-existent or not respected.</li> <li>(iii) The time allowed for the legislature’s review is clearly insufficient for a meaningful debate (significantly less than one month).</li> <li>(iv) Rules regarding in-year budget amendments may exist but are either very rudimentary and unclear OR they are usually not respected.</li> </ul>

3.159 Before the NWFP budget is presented in the Assembly, it is laid before the provincial cabinet where it is discussed and finalized. For dimension (i) the legislature’s review covers the

White Paper which includes fiscal policies, the medium term fiscal framework and medium term priorities as well as details of expenditure and revenue. On the basis of this, a rating of 'A' applies to this dimension.

3.160 The 'charged' expenditures under the Constitution are only subject to discussion in the house and all other estimates of expenditures and revenues are put to voting. Since the ruling party is represented both in the cabinet as is the majority in the Assembly, the budget presented in the Assembly is passed as it is, as is often the case in many other jurisdictions.

3.161 The Minister of Finance presents the budget documents annually along with a speech in the Assembly, normally in the third week of June, each year. After the budget speech, a rest day is given and, after which, discussions in the form of 'cut' motions commence. 'Cut' motions are received in the Assembly and a schedule is then issued to discuss these, grant-wise. The final voting takes place before June 30, and the budget is passed before the beginning of the fiscal year (July 1). For dimension (ii), since simple procedures exist for the legislature's budget review and are respected, in as much as no specialized committees are used, a rating of 'B' applies for that sub-rating element.

3.162 For dimension (iii), the budget is passed by the assembly after 10-14 days from start of deliberations, and this is less than the required one-month criterion for a 'B' rating and a required two-month criterion for an 'A' rating. However, since the budget is reviewed by the Cabinet and, even before that, by each individual Minister with active participation of, and in consultation with, the provincial political formations particularly during the budget formulation and preparation processes, time is provided at least tacitly, for reviews by the politicians. Also, the provincial budget cycle is partially dependent on finalization of the federal government budget, which conveys the exact estimate of fiscal transfers to the provincial government. As the federal budget is finalized and approved very close to the start of the new fiscal year, the time available to the provincial assembly for discussion becomes tight. On the basis of the underlying issues as above highlighted, a rating of "C" is equitably assessed for this dimension.

3.163 For dimension (iv), clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations. A rating of 'B' is hence assigned to this dimension.

3.164 Overall, therefore, under the MI rating methodology, a rating of 'C+' is assigned to this indicator.

## **PI-28 Legislative scrutiny of external audit reports**

Overall rating 'D+' for Provincial and 'D' for Districts/Local Governments.

3.165 The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through a legislative committee i.e. Public Accounts Committee (PAC) that examines the external audit reports and questions responsible parties about the findings of the reports. The effective and efficient operation of the committee depends on adequate financial and technical resource, and on adequate time being allocated to keep up to date on reviewing audit reports. The PAC may also recommend actions and sanctions to be implemented by the executive, in addition to adopting the recommendations made by the external auditors.

3.166 The PFM Framework related to this indicator examines the timeliness of examinations of audit reports by the PAC (for reports received within in the last three years), the extent of hearings on key findings undertaken by the PAC and the issuance of recommended action by the PAC and implementation by the executive.

3.167 The three dimensions assessed and their respective sub-ratings are as follows:

- i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years) – ‘D’.
- ii) Extent of hearings on key findings undertaken by the legislature – ‘B’.
- iii) Issuance of recommended actions by the legislature and implementation by the executive – ‘C’.

Score	Minimum requirements
<b>A</b>	(i) Scrutiny of audit reports is usually completed by the legislature within 3 months from receipt of the reports. (ii) In-depth hearings on key findings take place consistently with responsible officers from all or most audited entities, which receive a qualified or adverse audit opinion. (iii) The legislature usually issues recommendations on action to be implemented by the executive, and evidence exists that they are generally implemented.
<b>B</b>	(i) Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports. (ii) In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion. (iii) Actions are recommended to the executive, some of which are implemented, according to existing evidence.
<b>C</b>	(i) Scrutiny of audit reports is usually completed by the legislature within 12 months from receipt of the reports. (ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only. (iii) Actions are recommended, but are rarely acted upon by the executive.
<b>D</b>	(i) Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (ii) No in-depth hearings are conducted by the legislature. (iii) No recommendations are being issued by the legislature.

3.168 Pakistan does not have a very good track record of timely examination and resolutions of the issues in audit reports through PAC proceedings. Provincial accounts are routinely audited by the Auditor General of Pakistan and annual accounts submitted to the Legislature together with an audit certificate on the accounts. The audit reports for fiscal year 2003-04 have also been referred to PAC. However, barring FY 2001-02, PAC has not discussed any audit reports from years 1998-1999 onwards as yet. Thus no reports have yet been issued by the PAC within 12 months of the relevant year of audit. Dimension (i) is therefore rated 'D' for the PAC and the District *Zila* Accounts Committees. Discussions are in progress with the PAC to also start scrutiny of most recent reports first, rather than the older ones.

3.169 At the local government level, the PFM checks and balances included in the LGO 2001 are not yet fully operating; so there are major risks that are not being currently managed. *Zila* Accounts Committees (the district equivalent of the PAC), although established in some districts in the province, have weak operational capacities. For the continuous and effective working of the PAC at the provincial level, trained secretariat staff and adequate staffing strength are required for proper organization of meetings, improved reporting, and support to the PAC. In order to enable the PAC to review its performance and discover new endeavors in its role, proper research assistance to the Committee is also required. The PAC lacks adequate technical capacity to be able to efficiently and effectively conduct in-depth hearings to analyze the issues independently. However, in the absence of such limitations, the provincial PAC carries reasonably intensive and in-depth hearings on key audit findings, routinely, for some of the entities that received significant

audit findings. Audit paragraphs relating to less serious observations are routinely referred back to the DACs by the PAC so as to reduce, to the bare minimum, the number of audit issues that the Committee will need to deal with. The Committee’s conclusions are made available to the public through press releases. On the basis of the performance as highlighted above, dimension (ii) is rated 'B'. At the district level, however, the performance is a low rating of 'D'.

3.170 Analysis of the recent GoNWFP audit reports for the fiscal year 2002-03 reveals that the compliance to PAC’s directives by the departments is considerably low. The recommended actions are randomly implemented by the executive. In general, it can be concluded that there is little response to audit criticisms and recommendations at any level of government – a sign of major accountability weaknesses. There is presently no enforcement mechanism for implementing PAC recommendations. However, DG Provincial Audit NWFP is taking the initiative to assisting the PAC to improve on the follow-up mechanism. Dimension (iii) is therefore rated 'C'.

3.171 Following the M1 methodology for deriving the overall rating for the indicator, PI-28 is assigned a rating of 'D+' for the provincial government, diluted by a rating of 'D' for the local governments.

## **D Donor Practices**

### **D-1 Predictability of direct budget support**

Overall rating 'A'.

3.172 Direct budget support constitutes as an important source of revenue for central government in many countries. Poor predictability of inflows of budget support affects the government’s fiscal management in much the same way as the impact of external shocks on domestic revenue collection. Both shortfalls in the total amount of budget support and delays in the in-year distribution of the in-flows can have serious implications for the government’s ability to implement its budget as planned.

3.173 The two dimensions assessed, and their respective sub-rating elements are as follows:

- i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body) – 'A'.
- ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates) – 'A'.

3.174 The detailed criteria used for rating of each dimension are given in the table below:

<b>Score</b>	<b>Minimum requirements</b>
<b>A</b>	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.
<b>B</b>	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 10%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.

<b>C</b>	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in two of the last three years.
<b>D</b>	(i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies. (ii) The requirements for score C (or higher) are not met.

3.175 Budget support forecasts are provided by the donors and honored predictably. Any variation between forecast and actual is less than 5%; therefore, dimension (i) is rated 'A'.

3.176 Poor predictability of inflows of budget support affects the government's fiscal management in much the same way as the impact of external shocks as domestic revenue collection. The World Bank is the main budget support donor to the GoNWFP through its World Bank Development Policy Credits (DPCs). DPC 1-3 were largely timely as for 2 out of 3 years i.e. 2<sup>nd</sup> and 3<sup>rd</sup> years the DPC were paid to GoNWFP at the start of FY to facilitate alignment with the provincial budgetary planning cycle. Dimension (ii) is also rated 'A'.

3.177 Therefore, the overall rating assigned to D-1 is 'A'.

**D-2 Financial information provided by donors for budgeting and reporting on project and program aid**

Overall rating 'B+'.

3.178 Predictability of the disbursement of donor support for projects and programs affect the implementation of specific line items in the budget. Support can be delivered in a wide range of ways, with varying degrees of government involvement in planning and management of resources. A lower degree of government involvement leads to problems in budgeting for the resources (including presentation in the budget documents for legislative approval) and in reporting of actual disbursement and use of funds (which will be entirely the donor's responsibility where aid is provided in kind).

3.179 The two assessed dimensions and their related sub-ratings are as given below:

- i) Completeness and timeliness of budget estimates by donors for project support – 'A'.
- ii) Frequency and coverage of reporting by donors on actual donor flows for project support – 'B'.

Score	Minimum requirements
<b>A</b>	(i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification. (ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 85% of the externally financed project estimates in the budget, with a break-down consistent with the government budget classification.

<b>B</b>	<p>(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification.</p> <p>(ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 70% of the externally financed project estimates in the budget with a break-down consistent with the government budget classification.</p>
<b>C</b>	<p>(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid for the government's coming fiscal year, at least three months prior its start. Estimates may use donor classification and not be consistent with the government's budget classification.</p> <p>(ii) Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a break-down consistent with the government budget classification.</p>
<b>D</b>	<p>(i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start.</p> <p>(ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.</p>

3.180 Budget estimates are forecasted by the donors and the government's executing agencies at the beginning of the project for the program / project aid. The executing agencies prepare their PC-1s (project feasibility documentation) for approval by the P&D Department and other agencies as required, and the planned expenditures are included in the development budget of the province. Over 90% of all pledged and committed donor-aid are received according to schedule and factored in the government's budget on the basis of the government's chart of accounts. Investment projects funded by donors, however, have tended to be largely disbursed under 'ring-fenced' arrangements and hence do not use the government chart of accounts in terms of donor reports on disbursements. On the basis of the above, dimension (i) therefore scores an 'A' rating while dimension (ii) scores a rating of 'B'.

3.181 Overall, the rating of the indicator, using the MI scoring methodology is a 'B+'.

### **D-3 Proportion of aid that is managed by use of national procedures**

Overall rating 'A'.

3.182 The requirement that national authorities use different donor-specific procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. The use of national procedures for banking, authorization, procurement accounting, disbursement and reporting arrangement for donor funds as well as for government funds can help to focus efforts on strengthening the national procedures to mutual benefit. The criteria for rating of the indicator are:

Score	Minimum requirements
<b>A</b>	(i) 90% or more of aid funds to central government are managed through national procedures.
<b>B</b>	(i) 75% or more of aid funds to central government are managed through national procedures.

<b>C</b>	(i) 50% or more of aid funds to central government are managed through national procedures.
<b>D</b>	(i) Less than 50% of aid funds to central government are managed through national procedures.

3.183 World Bank Credits worth US\$ 253.27 million were transferred to the GoNWFP as budget support for the FY04 to FY06 based on the World Bank's lending - being the highest amongst other donors to the provincial government on annual disbursement basis. The proportion of aid managed through government procedures comes to 92.38%, while other investment projects managed outside government system constitutes only about 7.62% of overall aid.

3.184 As the percentage here exceeds 90%, therefore a rating for 'A' is assigned to this indicator.