

## **Chapter 4: Government reform process**

### **Description of NWFP Government reforms**

4.1 In NWFP, more than \$213 million has been committed through six initiatives. The principal donors are UNDP, World Bank, SDC, ADB and CIDA. EIROP has been a major devolution reforms support initiative funded by UNDP and SDC. The two Structural Adjustment Credits SAC & SAC II (DPCs) of The World Bank have provided major financial assistance in the form of budgetary support to the province. CIDA's initiative "CESSD" executed by the donor with the support of Pakistani partners has also been an important initiative. The NWFP Urban Sector Development Project is a major initiative to support improvement of urban infrastructure in the post devolution institutional environment.

4.2 In 2001, NWFP embarked on its Provincial Reform Program. The World Bank supported the reform program with a Structural Adjustment Credit (SAC) in July 2002 under the auspices of the Bank's 2002-2005 Country Assistance Strategy (CAS). The CAS emphasized support to provinces that had embarked upon comprehensive reform programs and had built credible track records on implementation, and the NWFP was one such province. The reforms address the key challenges to the Province's development and poverty reduction, aiming at accelerating human development, reducing poverty and vulnerability, increasing broad based, pro-poor economic growth, and strengthening public sector governance and law and order in the province. One of the pillars of such support is public financial management.

4.3 While NWFP was not the first province to embark on a comprehensive reform program, it was one that sustained the process. In line with the goals of the national PRSP, the overarching objective of the Province's reform program is poverty reduction, improved human development and facilitation of economic growth by restoring good governance and respect for the rule of law, enhancing effectiveness of public expenditures, and reestablishing the integrity of state institutions and their accountability to the public.

4.4 The Government of NWFP is taking action to implement the key elements of the public financial improvement plan agreed under the SACs (DPCs), including enhanced reconciliations, reduction in suspense accounts, progressive closure of off-budget accounts, upgrading of District Accounts Officers, embracing and taking advantage of PIFRA computerization, appointment of the Provincial Financial Coordinator (PFC) as the focal person for FM reforms, fielding of an effective Parliamentary Public Accounts Committee (PAC), and creation of DG District Audits. NWFP has also adopted a Public Procurement Law, and is the first province to do so, although this law needs to be revised to bring it closer to international best practices.

4.5 NWFP's Essential Institutional Reforms Operationalization Program (EIROP), conceived as a ten-year program, commenced in March 2001. The overall objective of the program is to enhance the well being of the people of NWFP by making the public sector more effective, efficient and responsive through decentralization, informed decision making and capacity building, working towards a system which is participatory, gender sensitive, transparent and accountable to beneficiaries. Target beneficiaries of the program include public sector institutions, policy makers, development planners, Local/District Governments and civil society organizations. Phase I of the project was implemented to focus on support to decentralization reforms in the province with a reasonable success. The focus areas of EIROP II set out in United Nations Development Assistance Framework Pakistan (2004-2008) include participatory governance through cooperation in institutional capacity building and strengthening of community level initiatives for empowerment and development of civil society. Gender is a fundamental cross cutting theme among all focus areas. In addition, Institutional Capacity Building through participatory monitoring and research, gender equality, strengthening and consolidation of the devolution

process, strengthening oversight and regulatory mechanisms at the provincial level, access to justice and human rights; and Community Development with Asset Building for the Poor through empowerment to support local participation in decision making, amongst other strategies, are part of the Results and Resources Framework set out in the UNDP Country Program Action Plan (CPAP) 2004-2008.

### **Institutional factors supporting reform planning and implementation**

4.6 Computerization of the financial management systems and the decentralization of government are the underpinning reforms to the institutional arrangement for PFM in the province. Under the Project for Improvement of Financial Reporting and Auditing (PIFRA), the Financial Accounting and Budgeting Systems (FABS), based on the new accounting model (NAM), has been implemented at the provincial and district government levels in NWFP. The accelerated pace of the project's implementation in NWFP has reached a stage of progress, first in the country, whereby all districts are now connected to the provincial government for budgeting, payment processing, accounting, in-year and year-end financial reporting, using a uniform chart of accounts across the entire province. By these means, the timeliness, comprehensiveness, reliability and accuracy of the financial information of the province has commenced to be best improved in NWFP compared to all other provinces.

4.7 While the province has made the best progress in implementing PIFRA, some fine-tuning issues still remain to be implemented. Data migration for previous years' data needs to be made into the new PIFRA system so that the Finance Department is able to retrieve previous years' financial information for its internal decision making. Some difficulties remain with the form and manner in which new object heads can be created in the chart of accounts (CoA), and there is a lack of synchronization of data across government formations due essentially to a non-absolute interface between the FD's server (budgeting) and the AG's server (accounting and reporting). Commencement of the use of the functionality for transacting and reporting on the Development Budget has yet to be fully addressed. The PIFRA SAP system has a comprehensive functionality for maintenance and management of Human Resources Management Information System (HRMIS) although the province is using a stand-alone application for initiating a comprehensive system in this regard in the interim. It is important that this HRMIS be integrated as part of the PIFRA in order to avoid duplication of work for the same objective.

4.8 The Decentralization Support Program (DSP) is being implemented with funding support from Asian Development Bank, to carry forward reforms in the areas of decentralization, fiscal restructuring and local governance. With the creation of local governments under the devolution program of the government, NWFP, like other provinces, encountered significant teething problems, including issues of lack of clarity in roles and responsibilities of the provincial and district governments, inadequate and low capacity of local government functionaries entrusted with budgeting, planning and implementing development schemes and improving service delivery, and on the design of the devolution process itself.

4.9 Lack of adequate staff skills in district governments and TMAs constrain service delivery. The skills deficiency is worst at the levels of the TMAs, where inadequate devolution of requisite staff has led to acute technical and coordination weaknesses.

4.10 Redefining the role of Local Fund Auditors is another institutional issue that can support the planning and implementing arrangements in the province.

## Annex 1: Summary of the Performance Indicators

Indicator	Score	Brief Explanation
<b>A: PFM out-turns</b>		
1. Aggregate expenditure out-turn compared to original approved budget	D	Actual primary expenditure (excluding donor funded projects) deviated from budgeted expenditure in FY03 and FY04 by more than 10%.
2. Composition of expenditure out-turn compared to original approved budget	C	Variance in expenditure composition for two out of the three years exceeded overall deviation in primary expenditures by more than 5 percentage points.
3. Aggregate revenue out-turn compared to original approved budget	D	Actual domestic revenue collection was below 92% of the budgeted domestic revenue estimates for two FYs.
4. Stock and monitoring of expenditure payment arrears	D	No data is maintained in relation to stock of arrears.
<b>B: Key Cross Cutting Issues</b>		
5. Classification of the budget	A	
6. Comprehensiveness of information included in budget documentation	B	The annual budget documentation does not disclose information regarding financial assets and prior year's budget out-turn.
7. Extent of unreported government operations	D+	Income / expenditure information captured in the fiscal reports against the loan financed and grant financed projects is incomplete, particularly related to PLAs and foreign-aided investment projects.
8. Transparency of inter-governmental fiscal relations	B	While other dimensions relating to inter-government fiscal relations performed well, the extent of consolidation of fiscal data of district and other local governments' to provincial government's according to sectoral categories is weak.
9. Oversight of aggregate fiscal risk from other public sector entities	C	Fiscal mechanisms are yet to be put into place effectively in order to capture financial information for local governments, other than for the district governments' level, on a regular basis. No aggregate fiscal oversight of state owned enterprises. This makes a completely consolidated overview missing or significantly incomplete for all levels of government and parastatal bodies.
10. Public access to key fiscal information	C	GoNWFP is maintaining a website through which some of the financial data is easily accessible. Public access to the procurement related issues is minimal. Audit reports are made available with a very significant time lag.
<b>C: Budget Cycle</b>		
11. Orderliness and participation in the annual budget process	A	The budget process is inclusive, comprehensive, and orderly.

12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	B	GoNWFP is following MTBF, but without adequate sector strategies.
13. Transparency of taxpayer obligations and liabilities	C+	Taxpayers' ability to contest decisions and assessments made by the revenue administration requires the existence of an effective complaints / appeals mechanism that guarantees the taxpayers a fair treatment. Though the tax appeals system of administrative procedures is operating in Excise & Taxation and Board of Revenue departments, they need to be fairer and less discretionary.
14. Effectiveness of measures for taxpayer registration and tax assessment	C	Lack of a database driven system weakens the control environment in the current taxpayer registration system, resulting in ineffective controls and enforcement system. Tax targets for the assessment process need to be streamlined and to be based on realistic assumptions and figures. This has a federal ownership content.
15. Effectiveness in collection of tax payments	D+	Collections, deposits and reconciliations are late and incomplete.
16. Predictability in the availability of funds for commitment of expenditures	C+	The departments have sufficient powers of re-appropriation, thus providing management flexibility. During the year adjustments to allocations in the light of unanticipated events affecting the revenues / expenditures are informed to the spending departments. Cash flow forecasts are not regularly prepared and updated. The unpredictability in the timing of receipt of budgeted revenues relating to <i>hydel profits</i> undermines predictability for commitment of expenditures and expenditure release mechanisms.
17. Recording and management of cash balances, debt and guarantees	B+	GoNWFP maintains an annual recording system for debts although bank balances as shown by SBP, FD and AG offices remain with high reconciliation differences.
18. Effectiveness of payroll controls	B+	Payroll controls, particularly with payrolls being processed under an IT environment have improved in NWFP.
19. Competition, value for money and controls in procurement	C	To ensure transparency and competitiveness the GoNWFP needs to ensure the enforcement of the law and use standard bidding documents in all public procurement and to implement the new Procurement Law.
20. Effectiveness of internal controls for non-salary expenditure	C+	Despite the role of the pre-audit function in pre-payment checks and validations (sometimes over-exercised), there still remains key internal control weaknesses to be addressed to improve accountability performance.

21. Effectiveness of internal audit	D	The coverage and quality of the internal audit function and extent of management response to internal audit reports findings are missing in the current system as no internal audits, consistent with the requirements of the function, are being implemented.
22. Timeliness and regularity of accounts reconciliation	B	While concerted efforts are made to reconcile the consolidated fund financial transactions (NWFP being the best provincial performer in this regard), the public account has remained largely un-reconciled. Full system interfaces between Banks, Revenue Departments, and the Accounting formations, in an automated (SAP/R3) environment, would support full reconciliation prospects.
23. Availability of information on resources received by service delivery units.	B	GoNWFP, generally, avails information, through funds releases, to service delivery units through their respective DDOs, and such information is also contained in the approved budget documents. Education and health functions and their attached departments prepare for their internal use, adequate information on resources received and utilized as part of their DDO functions, although the reliability of such information is less than adequate.
24. Quality and timeliness of in-year budget reports.	C+	The budget execution reports/civil accounts are of uneven quality despite their improved timeliness. No budget/actual comparisons are widely made.
25. Quality and timeliness of annual financial statements	B	Normally, accounts are prepared and submitted to the external audit by April of next year that is within 10 months of the end of financial year but not made public for some time.
26. Scope, nature and follow-up of external audit	D+	The audit report on the GoNWFP 2004-05 accounts is yet to be completed by the AGP; similarly the district audit reports covering the 2003-04 are yet to be presented to the legislature. Response or follow-up from the auditees has been less forthcoming in many respects.
27. Legislative scrutiny of the annual budget law	C+	Little time (less than one month) is allowed for the legislature to review proposals.
28. Legislative scrutiny of external audit reports	D+/D	PAC often lacks technical capacity to be able to efficiently conduct in-depth hearings and to analyze issues independently; it takes well over two years for a report to be disposed, and there is a substantial backlog of reports to be examined. All these against the backdrop that over the last 5 years, only two years' report of the PAC were only finalized and laid before the Assembly.
<b>D: Donor Responsibility</b>		

1. Predictability of Direct Budget Support	A	Donors and government agree well in advance about timing of first disbursements on budget support and this is respected.
2. Financial information provided by donors for budgeting and reporting on project and program aid	B+	Donors do not use government chart of accounts to report on investment projects, even if a government agency is implementing the project.
3. Proportion of aid that is managed by use of national procedures	A	Most (>90%) of aid disbursements to the province are in the form of direct budget support and government systems and procedures are used.