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## PUBLIC SECTOR ACCOUNTING

### A. Institutional Framework for Public Sector Accounting

7. The institutional framework for public sector accounting should include adherence to international accounting standards and use of qualified accounting staff to provide timely, relevant, and reliable financial information that is needed to support all fiscal and budget management, decision-making, and reporting processes. The diagnostic questionnaires, which were used in this assessment, have collected information on the current arrangements and the apparent gaps in Pakistan for accounting laws and regulations; education and training of public sector accountants; application of a code of conduct; and numbers and characteristics of public sector accountants.

#### *(1) Accounting Laws and Regulations*

8. **The Constitution of Pakistan delineates the authority of the Auditor General of Pakistan for prescribing the form, principles, and methods of accounts of the Federation and of the Provinces with the approval of the President.** Under these conferred powers, the Auditor General has endorsed the Accounts Codes (Volume I to IV) and a New Accounting Model (NAM) for implementation when practicable.<sup>10</sup> The PIFRA project is computerizing the accounting functions to enable the New Accounting Model to be implemented. Accounting functions are the responsibility of the Controller General of Accounts.

9. **A committee should be setup to review and steer the process of implementation of IPSAS on a progressive basis.** The committee should have oversight of the financial reporting specialists in steering the adoption of IPSAS towards the accrual basis of accounting.<sup>11</sup> The NAM development in 1998 used the IFAC-issued Guidelines for Governmental Financial Reporting and best practice from other countries.<sup>12</sup> There is now an opportunity to apply the IPSAS, that have been developed since 1998, in the

<sup>10</sup> The New Accounting Model is a set of 7 books: Accounting Principles Manual, Accounting Policies and Procedures Manual, Chart of Accounts, Accounting Guidelines, Accounting Procedures for Self-Accounting Entities, Book of Forms, and Financial Reporting Manual.

<sup>11</sup> Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities, International Federation of Accountants Public Sector Committee Study 14, December 2003.

<sup>12</sup> The New Accounting Model sets the national standards of accounting and financial reporting. Pricewaterhouse Coopers analyzed differences between IPSAS and the New Accounting Model in 2004. The New Accounting Model is being implemented using the cash basis of accounting and will gradually move towards the accrual basis. Formal adoption of IPSAS would enable the customization of the NAM financial reporting formats in compliance with relevant IPSAS requirements.



New Accounting Model and review the accounting model during its implementation. The Auditor General of Pakistan and Controller General of Accounts have already been engaged in deliberations to move towards adopting IPSAS. The adoption of IPSAS II cash flow formats is a step in this direction.<sup>13</sup> The NAM Financial Reporting Manual provides for such reporting, which generally complies with Cash Basis IPSAS.<sup>14</sup> This reporting also includes the optional disclosure requirements that are required to accord with IPSAS, such as third party payments and receipts that need to be identified and shown in a separate column. State-owned enterprise results should be consolidated into the annual accounts. Annex D discusses the benefits of accrual basis of reporting.

10. **The PIFRA project is supporting the implementation of the New Accounting Model.** Institutional and individual capacities in both the public sector financial management agencies, as well as the executive/service delivery formations are being developed through implementation of a comprehensive capacity development program mainly sponsored by PIFRA. The PIFRA project is supporting the implementation of the New Accounting Model through the implementation of computer accounting hardware and software application to all district accounts offices.

## **(2) Education and Training**

11. **The Audit and Accounts Training Institute (AATI) is a countrywide network providing professional training in public financial management to both accounting and executive arms of the government.** The AATI conducts long-term courses that lead to the Pakistan Institute of Public Finance Accountants (PIPFA) certification.<sup>15</sup> The AATI also conducts short courses for professional development.

12. **The AATI has included the use of IPSAS in its course work.** Through the technical assistance provided under the PIFRA, AATI has revitalized its syllabi and learning methodologies. It is now geared to teach areas of practical application, including IPSAS. The AATI has developed a comprehensive annual training program and has set targets for the first year.

13. **Offering international education standards will help to develop more professional audit and accounting staff.** The strategy is to offer learning opportunities to develop qualifications that are compliant with the IFAC International Education Standards (IES) and acceptable to other professional accountancy bodies. The AATI has been cooperating with professional accountancy bodies to seek

<sup>13</sup> Notification of financial reporting policy, dated June 29, 2005, adopts Cash Basis IPSAS with a trial implementation of the policy for FY2004-05 and effective date in FY2005-06.

<sup>14</sup> The annual financial statements consists of the following: (a) statement of assets and liabilities, (b) statement of revenues and expenditures (by function and by object), (c) statement of cash flows, (d) notes to financial statements, (e) summary of appropriation accounts by grants and appropriation, (f) appropriation accounts by economic function and department/division (g) appropriation accounts by grant, and (h) analysis of revenue by division/department.

<sup>15</sup> The PIPFA is a body of professional accountants and an associate member of the International Federation of Accountants. It is a joint initiative of the Auditor General of Pakistan, the Institute of Chartered Accountants of Pakistan, and the Institute of Cost and Management Accountants of Pakistan.



acceptance of AATI qualifications that would meet the qualifications for professional accreditation of other professional bodies — the Association of Chartered Certified Accountants (ACCA), UK; Institute of Chartered Accountants of Pakistan (ICAP); and Institute of Cost and Management Accountants of Pakistan (ICAMP).

14. **The selection and training of government accountants differs from one departmental cadre to another, and falls short in ensuring the qualifications essential for providing competent professional accounting service in the public sector.** The bachelor of commerce/accounting is the minimum academic requirements for an individual seeking to work in the departmental cadre of public sector accountants. However, the inter-departmental cadre civil servants do not require such qualifications; they are recruited as generalists through the Federal Public Service Commission. These inter-departmental officers are given nine-months of probationary training at the AATI and are encouraged to take further specialist training. Nevertheless, this approach continues to fail to provide for competent professional accounting service, equivalent to that provided by the private sector with its ICAP requirements.

### **(3) Code of Conduct**

15. **A code of ethics should be included in staff contracts.** The INTOSAI Code of Ethics has been adopted by the Auditor General of Pakistan and should be followed by staff doing audits and maintaining accounts.<sup>16</sup> The same has been included in the AATI syllabus. As such, the code of ethics is part of the overall guidance provided by the head of an organization to each staff member. Non-compliance of the code could lead to actions in accordance with Efficiency and Discipline Rules of the Government of Pakistan. The code of ethics should be made a part of staff contracts upon acceptance of a job, or separately signed by the employees as a legally enforceable document.

### **(4) Public Sector Accountant Arrangements**

16. **Duality of control over accounting staff should be resolved.** With the exception of a few departmentalized accounts, the Government follows a regime of centralized accounting offices that keep accounts of all departments in their regional jurisdiction. Out of 10,000 staff posted in the accounts offices, 921 staff members are employed by the federal government. The remaining staff comes mainly from the treasury services under the provincial finance departments. These provincial offices serve under the technical supervision of the Accountant General who is responsible to the Comptroller of General Accounts; but treasury staff is answerable to the Secretary of Finance of the relevant province. This duality of control over the accounting staff remains a problem of administration and authority and needs to be resolved.

<sup>16</sup> Some adaptations and deletions were made by a committee constituted by the Auditor General of Pakistan in connection with issuing the INTOSAI Code of Ethics and Auditing Standards. Only one paragraph relating to political neutrality (paragraph 21) was deleted from the Code of Ethics and minor changes of nomenclature were made.



17. **Budget officers (chief financial officer) should be adequately qualified to maintain internal financial control.** The budget officers should have the qualifications to undertake responsibility for maintaining systems of internal financial controls that manage risks, and for preparing regular financial management reports for the principal accounting officer.<sup>17</sup> The principal accounting officer is generally supported by a budget officer from within that line agency. These agency staff members require substantial training to equip them with the necessary tools of financial management to effectively assist the principal accounting officers. New positions of Chief Finance and Accounts Officers (CFAO) have been introduced under the system of financial control and budgeting introduced in September 2006. The system specifies that the CFAO shall be a well-trained and experienced officer. It is important that the Establishment Division which is to arrange the postings of these officers, ensures that this requirement reflects the expertise needed for the function.

18. **Internal audit units should be established as per staffing and operational planning developed under PIFRA.** Under PIFRA, a comprehensive plan was developed to initiate the internal audit function in government agencies for which a center of excellence is envisaged within the office of the Comptroller of General Accounts. Chief audit officers have been posted in 15 federal ministries with responsibilities for internal audit, reconciliation of accounts, coordination with departmental and parliamentary Public Accounts Committees, and the financial propriety of expenditure and receipts. More funding should be arranged to enable an effective internal audit function as per the staffing and operational plans developed under PIFRA.

## B. Accounting Standards as Practiced

19. The diagnostic questionnaires collected information on the current arrangements and the apparent gaps in Pakistan for setting public sector accounting standards, and for presenting financial reports.

### (1) Setting Public Sector Accounting Standards

20. **In the existing format of the finance and appropriation accounts, there are considerable departures from Cash Basis IPSAS.** Gradually the budget sector is being converted to the NAM Chart of Accounts. Conversion to the NAM reporting framework is dependent on the roll-out of the PIFRA accounting systems and the implementation of all the accounting functions. Pensions, general provident fund, and asset accounting are examples of functional modules yet to be implemented. Government accounts are presented in the old formats of the finance and appropriation accounts.

<sup>17</sup> The principal accounting officer is usually the secretary of a ministry or head of the line department.



## (2) Presenting Financial Reports

21. **Use of the cash basis of financial reporting provides a necessary scope to the implementation of the New Accounting Model.** One particularly useful feature of the Cash Basis IPSAS format is the disclosure of third party payments in separate columns on the face of the statement of cash receipts and payments. These disclosures enable users to identify the total amount of payments made; the purposes for which they were made; and whether, for example, the payments were made from amounts allocated or appropriated from general revenue or from special purpose funds or other sources. A case in point within the government sector is the payment of the electricity utility, WAPDA, by the central government, which then deducts these payments at source from its transfers to provincial governments. Provincial governments in turn deduct at source from transfers to local governments. As provincial and local governments are not well-notified of these deductions (as would be required in meeting Cash Basis IPSAS), they become a source of confusion and inefficiency. The government entities are unaware of their power costs and hence less likely to seek ways to be more economical. Also, as bills are already “paid,” there is less incentive for the utility to ensure that its records reconcile with customers' records.

22. Table I identifies the current position and steps required if the Cash Basis IPSAS were to be adopted.

**Table I. Required Steps for Adopting Cash Basis IPSAS**

Requirements	Current deficiencies	Activity required to adopt Cash Basis IPSAS
Financial statements presented in IPSAS	The Pakistan reporting structure focuses on consolidated fund and public accounts and the Cash Basis IPSAS for financial statements is not followed.	A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared using existing information from the accounting records. Also, for each entity (i.e., ministry and department), an additional statement in accord with Cash Basis IPSAS can be prepared. This may require some restructuring of the NAM computerized reporting formats. <sup>18</sup>
Information required in accordance with IPSAS in the statement of cash receipts and payments	All this information is available on the government reporting system, but is in formats inconsistent with IPSAS. Some negative balances are appearing in the finance accounts. The cash balance appearing in the financial statements is not reconciled with the bank accounts and	This work requires restructuring of the reporting formats and rectification of errors in recording and compiling the accounts. Third party payments would be shown separately in the Cash Basis IPSAS format.

<sup>18</sup> It is understood that changes in the financial reporting formats would not be considered as a departure from the new structure of accounting policies and practices as approved by the Auditor General with the consent of the President.





Standard	Current status	Activity required to adopt international standards
	receivables are appearing from bodies that no longer exist.	
Accounting policies and explanatory notes	Statements of accounting policy are not provided in the budget or accounts documents.	There is a need to state the accounting policies for various elements of the financial statements and the basis on which the accounts are prepared.
General considerations reporting period adequacy of information about the entity presentation of comparative	At present financial statements are not available within 6 months of the reporting period; cash balances that are available for use and cash balances that are subject to external restrictions and un-drawn borrowing facilities are not disclosed, and presentation does not meet certain transparency requirements. Although the authorization date is mentioned on the accounts, it is not clear when these financial statements become accessible to the general public or media.	It would be necessary to reduce the reporting lag; and to disclose further information. Legislation should enforce specific timelines for the publication of annual audited financial statements of the government.
Correction of errors disclosed nature of error amount of correction comparative information restated	The nature of errors in prior periods, the amount of the correction, and the fact that comparative information has been restated, or that it is impracticable to do so, is not disclosed.	Further training and better supervision of accounts officers would be needed to correctly classify expenditures and disclosure of errors rectified prior to the reporting period and restatement of comparative information where practicable.
Consolidated financial statements	The government budget sector is a reporting entity, as well as an economic entity.	A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared. Further steps will be needed to include controlled entities as per IPSAS and Section 7(b) of the CGA Ordinance.
Treatment of foreign currency cash receipts, payments, and balances treated in compliance with IPSAS	The government largely follows IPSAS except for the disclosure aspects in respect of accounting treatment of foreign currency.	Need to comply with the disclosure aspects of the accounting and financial reporting treatment of foreign currency.
Effective date of IPSAS Part I and transitional provision compliance.	The government has not formulated a migration path and timeline for achieving Cash Basis IPSAS, Part I,	Need for the Auditor General to formally adopt IPSAS and for the CGA to prepare an implementation plan and timeline



Requirements	Current deficiencies	Activity required to adopt Cash Basis IPSAS
	compliance.	setting out specific steps to be taken, including disclosure, if necessary, of application of the transitional provision (i.e., full compliance achieved within 3 years) for reporting periods beginning on a date within 3 years of first adoption of IPSAS.

### C. Assessment of Accounting and Auditing in State-Owned Enterprises

23. **It should be mandated by law that the financial statements of the state owned enterprises be prepared in accordance with the IAS/IFRS.** Many state-owned enterprises are registered under the Company Law. Under the Companies Ordinance 1984, it is obligatory for all listed companies to present their financial statements in accordance with IAS/IFRS.<sup>19</sup> These companies are required under the Companies Ordinance to be audited by a chartered accountant. The Institute of Chartered Accountants in Pakistan has mandated the observance of International Standards on Auditing by its members. Upon receipt from the IFAC, exposure drafts of proposed International Standards on Auditing are sent to ICAP members for comments. These comments are returned for consideration by IFAC. When the final standard is issued, ICAP adopts the International Standard on Auditing without modification. For non-listed companies, the implementation and enforcement of IAS/IFRS is not finalized. Enforcement of International Standards on Auditing for the audit of non-listed companies is less stringent than that for the listed companies. State-owned enterprises, which are not incorporated under the Company Law, do not usually apply IAS/IFRS for accounting and financial reporting. The financial statements are generally audited after a long lag time.

24. **There are serious issues relating to the use of public funds in state-owned enterprises that are not subjected to legislative scrutiny by the Public Accounts Committee.** A review of a sample of financial statements of state-owned enterprises that are audited by Chartered Accountants indicated that the audit reports generally contained either significant qualifications and/or emphasis of matter paragraphs modifying the audit opinion. The Auditor General of Pakistan while conducting the regularity or performance audit cannot utilize the qualifications given in the audit report on the financial statements. The Auditor General does not have access to the management letter given by the external auditors to the state-owned enterprises, nor do they have access to the financial audit working papers. Thus serious issues relating to the use of public funds are not subjected to legislative scrutiny by the Public Accounts Committee

<sup>19</sup> The Report of Observance of Standards and Codes – Accounting and Auditing in, Pakistan, 2005, provides the implementation status of IAS/IFRS and related issues.



through consideration of the Auditor General's reports. The preferable practice is for the Auditor General to be able to review the working papers and reports of the contracted audit firms.<sup>20</sup>

25. **There is a need for specialized training in the utilizing of IAS/IFRS, ISA, and using the work of other auditors.** The resources for auditing public sector enterprises in the DAGP are in short supply; and DAGP staff generally is not adequately trained in accounting. The need for additional specialized training in the applications of IAS/IFRS and ISA and using the work of other auditors has been recognized as a need. Greater provision of this training could be provided perhaps through the AATI or outsourced to the private sector institutions.

26. **The Commercial Audit Wing of the Auditor General of Pakistan should perform a monitoring role for the compliance of IAS/IFRS by state-owned enterprises.** Monitoring of state-owned enterprises needs improvement. There is currently no Public Sector Enterprises Monitoring Board as established in other countries. This role is performed by the Corporate Wing of the Ministry of Finance. Some proposals are in place for strengthening the Corporate Wing. There is little involvement of the Auditor General in the selection of the external auditors of these state-owned enterprises.<sup>21</sup> The respective ministries/departments with which individual state-owned enterprises are attached exercise varying levels of monitoring on these bodies. Many of these state-owned enterprises are outside the enforcement mechanisms (of IAS/IFRS and other financial reporting) by the Securities and Exchange Commission of Pakistan and the State Bank of Pakistan. Hence, there is a need for the Commercial Audit Wing of the Auditor General of Pakistan to be strengthened to perform a more comprehensive review role for the compliance of IAS/IFRS by state-owned enterprises.

<sup>20</sup> Section 25, A Model National Audit Office Act, The Association of Chartered Certified Accountants, UK, 2004.

<sup>21</sup> Although there is a requirement to get approval of the selected auditor's (CA) name, in many cases it is not observed. Even with compliance, in practice management finalizes the selection of the audit firm, a practice that throws into question the independence of these auditors.

