



EXECUTIVE SUMMARY

1. This assessment of public sector accounting and auditing is generally meant to help implement more effective public financial management (PFM) through better quality accounting and public audit processes in Pakistan and to provide greater stimulus for more cost-effective outcomes of government spending. More specific objectives are (a) to provide the country's accounting and audit authorities and other interested stakeholders with a common, strongly-founded, knowledge as to where local practices stand against the internationally developed norms of financial reporting and auditing; (b) to assess the prevailing variances; (c) to chart paths for improving the accordance with international standards; and (d) to provide a continuing basis for measuring improvements.

2. Annex A explains the methodology used for the assessment. The desired actions indicated by this assessment are summarized below.

3. **Adopt International Public Sector Accounting Standards.** The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) issues International Public Sector Accounting Standards (IPSAS). Annex B gives a general description of IFAC and a listing of the IPSAS. At the present time, Pakistan does not comply with the IPSAS in preparing its annual accounts. The country's accounts do not provide a statement of cash receipts and payments which (a) recognizes all cash receipts, cash payments, and cash balances controlled by the entity; and (b) separately identifies payments made by third parties on behalf of the entity in accordance with paragraph 1.3.24 of this IPSAS. In addition, the country's accounts do not provide accounting policies and explanatory notes. A general program is underway for the adoption of accounts in a form specified in its New Accounting Model (NAM). This form of reporting was developed in 1998 and adopted the then proposed modified cash basis of accounting standard.¹ The IPSASB has not approved this form of reporting as an official standard. It has established standards for accrual-based reporting and also the Cash Basis IPSAS together with guidance for transition to an accrual basis of accounting. Under the guidance of the Auditor General of Pakistan (AGP), the Controller General of Accounts (CGA) needs to restructure the present cash basis of financial reporting to conform fully to the Cash Basis IPSAS. While the IPSAS-2 reporting format has been designated by the Auditor General as additional reporting requirements for the government, it would be appropriate to set up a committee to review and steer the process to implement Cash Basis IPSAS on a continuous basis. With strengthened capacity effected by recruiting financial reporting specialists for the CGA administration, a

¹ The modified cash basis of accounting helps in controlling not only cash but also commitments against budget, allowing the production of a statement of receipts and payments, a statement of assets and liabilities, and a cash flow statement.



transition to full Cash Basis IPSAS—while also adopting the Modified Cash Basis IPSAS as per the New Accounting Model (NAM) —can be smoothly accomplished, although the problem of consolidation of controlled entities would still persist. The Government noted in its response to the draft report that the requirements of the cash basis of accounting have been incorporated in the NAM Manual of Accounting Principles and its Procedures Manual and that the progressive implementation of the NAM will meet all the requirements. As a next step, a transitional path should be developed that presents the full accrual information to best serve the general financial statements as required under Section 7(b) of the CGA (Appointment, Functions and Powers) Ordinance 2001. Annex C includes the pertinent text of the Constitution and the AGP and CGA Ordinances. Benefits from adopting accrual reporting are set out in Annex D.

4. A Supplementary Table of Standards and Gaps of this report provides a matrix detailing the current standards, the present position, and options for improvement. A summary of the accounting standards issues is shown in Table ESI.

Table ESI. Summary of Accounting Standards Issues in Pakistan

Standard	Current status	Activity required to adopt international standards
1. Does the Public Sector Accounting Law adopt IPSAS?	Only partially. The notification of the adoption of the IPSAS-2 cash flow reporting format as part of the overall reporting requirements of the government is a step in the right direction.	A committee should be set up to review and steer the process to implement full cash basis of financial reporting on a continuous basis. The financial reporting specialists should steer the process as key members of the committee. Upon implementation of the Cash Basis IPSAS as additional reporting requirements of the government, the committee should gradually begin the transition to adopting accrual-based IPSAS. The PIFRA project is providing the necessary support for computerization of the accounts and capacity building of the staff.
2. Does the education and training of accountants accord with IES?	Partly. A comprehensive training strategy is directed toward the professionalization of accounting staff through IES-compliant qualifications.	Implement the training and professionalization strategy, and include IPSAS in AATI syllabi.
3. Does the code of ethics match international standards?	Yes. The Auditor General has adopted the INTOSAI Code of Ethics.	The code of ethics should be made a part of the staff contracts.
4. Is there a body to prescribe public sector accounting standards?	Yes. The Constitution of Pakistan delineates the authority of the Auditor General of Pakistan to prescribe the	While IPSAS should be the core framework for financial reporting, with the





Standard	Current status	Activity required to adopt international standards
	form, principles, and methods of accounts of the Federation and of the Provinces with the approval of the President.	Modified Cash Basis under the NAM, IAS/IFRS should be the approved standards for accounting and financial reporting for all state- owned enterprises.
5. Are financial statements presented in accord with the IPSAS?	To a limited extent. The Cash Basis IPSAS for financial reporting is not yet followed, nor is the accrual-based IPSAS. The CGA has the responsibility for preparing and maintaining the accounts of the Federation, the Provinces and district governments. The CGA also lays down the principles governing internal financial control but certain accounting offices still remain with the provincial governments.	There are 3 identified gaps: (1) Accounting policies and notes to the accounts are absent. (2) Third party transactions are not included. (3) Controlled entities' financial information is not consolidated. The functions of the chief financial officer and internal auditing within each government entity should be strengthened to assist with the reliability of the reporting. Duality of control by provincial and national governments over some offices under the CGA authority needs to be resolved for coherent reporting and undiluted administration of the accounting and reporting function.
6. Is the statement of cash receipts and payments in IPSAS form?	No. A basic statement of cash receipts and payments is provided but this information is currently presented in formats inconsistent with the IPSAS.	A statement of cash receipts and payments as per the IPSAS Cash Basis can be prepared using existing information from the accounting records. This work requires some restructuring of the financial reporting formats.
7. Are accounting policies and explanatory notes required?	No. Statements of accounting policies are not provided in the budget or accounts documents.	There is a need to state the accounting policies and the basis on which the accounts are prepared.
8. Are other disclosures in accord with IPSAS?	Partly. Financial statements are not available within 6 months of the reporting period; some items are not disclosed, and presentation does not meet some transparency requirements.	It would be necessary to reduce the reporting lag, improve reconciliations, and disclose further information (e.g., on the treatment of foreign currency).
9. Does the government issue a consolidated financial statement that consolidates all controlled entities?	No.	A statement of cash receipt and payment as per the Cash Basis IPSAS can be prepared. Further steps will be needed to consolidate the financial information of the controlled entities.



5. **Implement the Financial Audit Manual that has been prepared using the IFAC-issued International Standards on Auditing (ISA), as well as of the International Organization of Supreme Audit Institutions (INTOSAI).** The Auditor General of Pakistan has approved the new Financial Audit Manual, which follows the modern risk-based certification audit approach. A program for implementation of this Manual is in preparation. The Auditor General has already formally adopted the INTOSAI Auditing Standards with minor modifications. The INTOSAI recognizes that its Auditing Standards are broad in nature and that the IFAC-issued International Standards on Auditing provide a further level of detail for public sector audit guidance. The INTOSAI is working with IFAC in the longer term to develop practice notes to assist with the implementation of each ISA in the public sector. Annex B lists the INTOSAI and IFAC standards.

6. **Improve the jurisdiction, mandate, and functions of the Auditor General of Pakistan as envisaged in the Auditor General Ordinance 2001, and strengthen the reporting and disclosure processes of audit conclusions.** Auditing practices need to be revised in line with the INTOSAI Auditing Standards, IFAC-issued International Standards on Auditing, and the new Financial Audit Manual. Reporting of audit results needs to be more timely and to be disseminated more publicly. The incentives for auditees to take action on audit findings would increase by facilitating easy access to, and greater dissemination of, audit reports. And this would be helped by more focused and effective report writing and report follow-up processes.

7. A Supplementary Table of Standards and Gaps of this report provides a matrix detailing the current standards, the present position, and options for improvement. A summary of auditing issues is shown in Table ES2.

Table ES2. Summary of Auditing Standard Issues

Standard	Current status	Activity required to adopt international standards
1. Is the SAI statutory framework in accord with the needs of the INTOSAI Auditing Standards?	Partially. Some additional powers need to be established by legislation as set out below.	Some revisions in the Auditor General Ordinance 2001 are required.
2. Is there a body to prescribe public sector auditing standards?	Yes. It has been construed from various provisions of legislation, including Section 22 of the Auditor General Ordinance 2001 that the Auditor General would be the standard-setting authority for public sector auditing. Thus, the Auditor General adopted INTOSAI Auditing Standards as recommended by a	To improve on this, the Auditor General should coordinate with ICAP to form a Public Sector ISA Committee for review and adoption of ISA.





Standard	Current status	Activity required to adopt international standards
	committee of senior officers in the DAGP.	
3. Have INTOSAI and IFAC audit standards been adopted?	Partly. The Auditor General has adopted INTOSAI Auditing Standards.	A Public Sector Committee should be used to adopt ISA and develop formal implementation notes for guidance. ²
4. Has a code of ethics equivalent to the INTOSAI Auditing Standards been adopted?	Yes.	
5. Is the accountability process in the SAI in accord with INTOSAI Auditing Standards?	Yes.	
6. Does the SAI legal framework meet the INTOSAI Auditing Standards for independence and powers?	Largely.	The Auditor General needs improved legislation to exclude limitations on jurisdiction, mandate, and function of this position; and improved offence clauses together with enhancement in transparency and disclosure of audit conclusions. While not mandatory, the national audit legislation should match international models. ³
7. Does the education and training of the auditors accord with INTOSAI and IES?	Partly. Staff needs more professional training.	The AATI should continue to review its syllabus to cover all areas recommended by the IFAC educational standards.
8. Is the SAI equipped with the audit methods and technologies to meet the INTOSAI Auditing Standards?	Yes. But not implemented in full at the moment.	Improved methodologies are being implemented. The technology required to support a management information system for the Auditor General is missing. The requirements are being acquired through PIFRA. The implementation plan will review capacity for implementing the new Financial Audit Manual.

² Pakistan should nominate persons to the Reference Panel of the INTOSAI Working Group on Financial Audit Guidelines, which is a subcommittee of the INTOSAI Auditing Standards Committee.

³ Guidance is provided by (1) a general prescription of a model law developed by the UNDP Program for Accountability and Transparency (PACT) and (2) the Model National Audit Office Act by The Association of Chartered Certified Accountants, UK, 2004.



Standard	Current status	Activity required to adopt international standards
9. Does the SAI have the requisite quality assurance programs to meet international standards?	Partly. Internal quality assurance and supervision provide review arrangements among the field audit offices.	Improved working paper guidance and computerization combined with more effective supervision and more independent quality review processes are needed.
10. Does the process to plan the audits meet international standards?	Partly. Improved methodologies are being implemented.	The audit process should be risk-based allowing sufficient flexibility to the auditors to articulate and apply appropriate audit procedures on methodically selected samples to arrive at representative audit conclusions.
11. Does the process of supervising the audits meet international standards?	Partly. Working paper systems and audit methodologies do not currently enable effective supervision. Improved methodologies are being implemented under PIFRA.	The revised working paper structure should be implemented together with the new Financial Audit Manual for audit supervision.
12. Does the process of evaluating the reliability of internal control meet the international standards?	Partly. Improved methodologies are being implemented.	The methodology needs to be more risk- and systems-based.
13. Does the process used in audits to assess compliance with laws meet international standards?	Partly. Improved methodologies are being implemented.	The methodology needs to be risk- and systems-based and may be integrated as planned with the annual certification audit.
14. Does the audit process used to obtain evidence to support conclusions meet international standards?	Partly. The evidence to support audit criticisms on individual transactions is for the most part better than that available to provide the more general audit assurance on the summary figures in the financial statements.	More rigorous plans for audit testing need to be developed as per the Financial Audit Manual. The evidence for more general audit assurance needs better organization.
15. Does the audit analyze the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with?	Partly. The existing structure of the financial statements only provides limited scope for financial analysis that is useful for certification audit.	The full implementation of IPSAS would improve the DAGP's ability to do meaningful and reliable financial analysis.



Standard	Current status	Activity required to adopt international standards
<p>16. Does the auditor prepare an audit opinion on the financial statements in a form that accords with international standards?</p>	<p>Not fully at this stage. The Auditor General signs an opinion on the accounts; but because the financial statements are not prepared in accordance with adequate standards, the wording of the audit opinion does not contain all of the requirements of ISA 700, <i>The Auditor's Reports on Financial Statements</i>. The wording does not clearly indicate the financial reporting framework used to prepare the financial statements, nor does it state the auditor's opinion as to whether the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with that financial reporting framework.</p>	<p>The CGA program to provide annual accounts in the IPSAS format needs to be established reliably. The timetable and program for the implementation of the newly adopted Financial Audit Manual needs to be specified to accord with the availability of auditable accounts. The Manual is aimed at forming an opinion on the truth and fairness of the financial statements so that the Auditor General can sign an opinion in accordance with ISA 700.</p> <p>The audit methodology specifies how the audit work can be planned to meet the confidence level that is implicit in the audit opinion, and identify the level and extent of audit testing required in order to express that opinion.</p>
<p>17. Does the consideration of fraud and error in an audit of financial statements accord with international standards?</p>	<p>Partly. Audits focus on examining transactions for discrepancies and regulatory breaches. Much of the reporting seems to relate to fraudulent behavior and suggesting recoveries without exposing the facts in detail.</p>	<p>The testing needs to be more statistically based. Forensic audit training is needed to categorize the observation as either a mistaken violation or a deliberate and intentional act to take undue benefit.</p>
<p>18. Are the Auditor General's reports made public?</p>	<p>Apparently. But only after tabling in the Parliament and consideration by the Public Accounts Committee. The legislation does not specifically require publication.</p>	<p>The audit legislation should formally provide for reports to be made public, and publicly available when tabled in the Parliament.</p>
<p>19. Is the process for taking action on audit recommendations sufficiently effective to meet international standards?</p>	<p>Partly. Improved audit, Public Accounts Committee, and departmental administrative processes are needed for follow-up of audit reports. There is an enormous backlog by the Public Accounts Committee in reviewing the audit observations. Effective review of the backlog is becoming increasingly impossible.</p>	<p>Improved audit methodology and report writing on the one hand and reform of the fundamental processes for scrutiny on the other, are required to reduce this backlog.</p>



8. **The Commercial Audit Wing of the Auditor General Pakistan should perform a stronger review role for the compliance with International Accounting Standards and International Financial Reporting Standards (IAS/IFRS) by the state-owned enterprises.** Since the financial statements of many of the state-owned enterprises (SOE) are not audited by the Auditor General of Pakistan, there are transparency issues relating to the use of public funds in these enterprises that may not be subjected to legislative scrutiny by the Public Accounts Committee. The reasons include, but are not limited to, the lack of capacity in the office of the Auditor General to coordinate and review the work of the external auditors of these enterprises. There is a need for specialized training in the use of international accounting and auditing standards, and in using the work of other auditors. Many of the state-owned enterprises are outside the IAS/IFRS and other financial reporting and enforcement regimes of the Securities and Exchange Commission of Pakistan and the State Bank of Pakistan. Those state-owned enterprises registered by the Securities and Exchange Commission of Pakistan should be audited by professional accounting firms that are selected by, and report through the Auditor General. There is a need for the DAGP Commercial Audit Wing (after it is strengthened) to review all state-owned enterprises for IAS/IFRS compliance. In addition, the Corporate Finance Wing in the Ministry of Finance, whose responsibility is to do more general monitoring, will be strengthened under a proposed capacity-building project. This project, funded by the World Bank, has not yet started.

9. **Continue to improve public financial management through the reform program. Public financial management relies on a comprehensive and timely accounting and financial reporting system.** This system should be supported by a professional audit function that assures competency and reliable information within the system. Current enforcement of adequate compliance with financial regulations in the general budget sector and corporate governance in the public enterprise sector falls short of satisfactory performance. The Country Financial Accountability Assessment for Pakistan concluded that there are significant challenges remaining within the country's public financial management reform agenda to improve the effectiveness and productivity of public spending.⁴ Ongoing reforms and capacity-building measures will help to strengthen performance in the PFM arena. Accountability based on the formal adoption of international accounting and auditing standards is a timely step for the Government of Pakistan to take now. And the implementation of these standards needs to be supported by a more comprehensive PFM reform program to achieve substantial positive impact. The PIFRA II is covering most of the required reform elements. The Finance Division has issued in September 2006 a memorandum⁵ covering a new system of financial control and budgeting which includes inter alia the specific duties and responsibilities of Principal Accounting Officers, Chief Finance and Accounts Officers, and Financial Advisers. Economy and regularity are the two main principles to be observed.

10. **Improve accounting and auditing skills of the Pakistan Accounts and Audit Service.** For bringing about improvements in compliance with international standards there is a need for properly trained staff. Current programs are providing strong support in this area. The success will depend on how well the strategies are implemented.

⁴ World Bank, Country Financial Accountability Assessment for Pakistan, **South Asia Region. December 2003.**

⁵ Establishment Division O.M. No F.3(2) Exp. III/2006 dated 13/9/2006

